S. Hrg. 100-183

REGULATING HOSTILE CORPORATE TAKEOVERS

HEARINGS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 227

TO AMEND THE SECURITIES EXCHANGE ACT OF 1934 TO IMPOSE ADDITIONAL RESTRAINTS ON CORPORATE TENDER OFFERS, AND FOR OTHER PURPOSES

S. 678

TO AMEND THE SECURITIES EXCHANGE ACT OF 1934 WITH RESPECT TO TENDER OFFERS, AND FOR OTHER PURPOSES

S. 1264

TO PLACE A MORATORIUM ON HOSTILE FOREIGN TAKEOVERS

S. 1323

TO AMEND THE SECURITIES EXCHANGE ACT OF 1934 TO PROVIDE TO SHAREHOLDERS MORE EFFECTIVE AND FULLER DISCLOSURE AND GREATER FAIRNESS WITH RESPECT TO ACCUMULATIONS OF STOCK AND THE CONDUCT OF TENDER OFFERS

S. 1324

TO AMEND THE SECURITIES EXCHANGE ACT OF 1934 TO PROVIDE FOR MORE EFFECTIVE DISCLOSURE AND TO CURB ABUSES WITH RESPECT TO ACCUMULATIONS OF STOCK AND THE CONDUCT OF TENDER OFFERS

JUNE 23, 24, AND 25, 1987

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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CONTENTS

TUESDAY, JUNE 23, 1987

Page

Opening statement of Chairman Proxmire 1
  S. 227 2
  S. 678 14
  S. 1264 23
  S. 1323 27
  S. 1324 47
Opening remarks of Senator D'Amato 109
  Prepared statement 111
Opening statements of:
  Senator Riegle 118
  Senator Dixon 118
  Senator Sasser 119
  Senator Sanford 120
  Senator Shelby 122
  Senator Metzenbaum 125

WITNESSES

Beryl Sprinkel, Chairman, Council of Economic Advisers 80
  Prepared statement 82
    I. The evidence on corporate control transactions 82
    II. The administration's position on corporate governance 85
    III. Comments on specific provisions of S. 1323 86
    IV. Conclusion 88
Charles Cox, Commissioner, Securities and Exchange Commission 89
  Prepared statement 91
    Introduction 91
    I. Section 13(d)—Disclosure of beneficial ownership 91
    II. Section 14(d)—Tender offer regulations 95
    III. Financing of tender offers 101
    IV. Management leveraged buyouts and going private transactions 102
    V. Remedies and penalties 103
    VI. Market regulations 105
    VII. Commission rulemaking and exemptive authority 106
    VIII. Role of State law 107
    Conclusion 107
  Response to written questions of Senator D'Amato 421
  Response to written questions of Senator Garn 469
Panel discussion:
  Negative attitude of Commission 108
  Defects in Federal legislation 123
  Excessive debt 130
  Do we need legislation? 132
  Antitrust laws and mergers 133
  Motivation for hostile takeovers 135
  Debt financing versus equity financing 137
  Abuses as to hostile takeovers 139
  Comments on Proxmire-Riegle bill 141
Daniel Bell III, President, North American Securities Administrators' Association 142
  Prepared statement 143

Page
Anthony J. Celebrezze, Jr., Attorney General of the State of Ohio 150
  Consequences of hostile takeovers 151
  Prepared statement 154
Jim Edgar, representing the National Association of Secretaries of State 159
  Prepared statement 160
Richard B. Geltman, staff director, Committee on Economic Development and Technological Innovation, National Governors' Association 161
  NGA recommendations 161
  Prepared statement 164
Panel discussion:
  Effect of Goldsmith raid on Goodyear 167
  Role of Federal Government 169
  Concern for the community 172

WEDNESDAY, JUNE 24, 1987

Opening statement of Chairman Proxmire 175
  Prepared statement 178
Opening statement of Senator Garn 179
Opening remarks of Senator Riegle 180
Opening statement of Senator Heinz 180
Opening remarks of Senator Hecht 181
Opening remarks of Senator Chafee 181
Opening statement of Senator Dixon 182
Opening statement of Senator Sanford 182
Opening statement of Senator Shelby 183

WITNESSES

John W. Bachmann, Chairman, Securities Industry Association 184
  Prepared statement 185
Robert F. Greenhill, Managing Director, Morgan Stanley & Co., Inc 198
  Legislation is needed 198
  Prepared statement 201
    I. Introduction 201
    II. Comments on S. 1323 203
    III. Conclusion 210
    Recommendations of the Capital Markets Group 210
  Response to written questions of Senator D'Amato 411
Panel discussion:
  More time means higher costs 220
  Pension funds 223
  Golden parachutes and poison pills 225
  Disagree with administration view 226
  Debt problem of takeover company 227
  Guidelines for legislation 229
  Recommendations 232
  Should Congress define insider trading 238
  Institutional investor 241
Laurence Gold, General Counsel, American Federation of Labor and Congress of Industrial Organizations 243
  Prepared statement 244
Witness discussion:
  Rights of employees 248

THURSDAY, JUNE 25, 1987

Opening statement of Chairman Proxmire 251
Opening statements of:
  Senator Dixon 252
  Senator Sasser 252
  Senator Sanford 253
  Senator D'Amato 333
  Senator Domenici 305
    Prepared statement 308

WITNESSES

Page
H. Brewster Atwater, Jr., Task Force on Corporate Responsibility, the Business Roundtable 254
  Basic policy questions 254
  How the game is played 259
  Prepared statement 262
Alexander B. Trowbridge, President, National Association of Manufacturers 292
  Disclosure 292
  Prepared statement 295
Donald C. Clark, representing Stakeholders in America 316
  Recommendations 316
  Prepared statement 318

Panel discussion:

  Delete greenmail, golden parachutes, and poison pill provision 321
  Ineffectiveness of present law 322
  Stockholder approval 325
  Relationship between Federal and State governments 326
  Flaws in legislation 330
  Golden parachutes 336
Raymond J. Sweeney, Cochairman, Council of Institutional Investors 338
  Support for legislation 338
  Prepared statement 341
Harrison J. Goldin, Cochairman, Council of Institutional Investors 346
  Trouble areas of proposed legislation 347
  Prepared statement 349
James S. Martin, Executive Vice President and Chairman, CREF Finance Committee, College Retirement Equities Fund 352
  Ban greenmail 353
  Prepared statement 355
Margaret Cox Sullivan, President, Stockholders of America, Inc., Washington, DC 357
  Williams Act should be updated 359
  Prepared statement 361

Panel discussion:

  Definition of a group of investors 367
  Purpose of legislation is to prevent abuse 368
  Are institutional investors part of the problem? 369

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

Financial Executives Institute, comments on proposed legislation S. 1323, from W. Gordon Binns, Jr., Chairman 372
General Mills, Inc., Business Roundtable views on S. 1323 from H.B. Atwater, Jr., Chief Executive Officer 381
"Wall Street's Superstars" article from magazine, Financial World, dated July 14, 1987 383
United Food & Commercial Workers International Union, statement by William H. Wynn, President 403
Arvin Industries, response to written question of Senator Proxmire of hearing dated March 4, 1987, from James K. Baker, Chief Executive Officer 407
The city of New York, office of the comptroller, comments on S. 1323, from Harrison J. Goldin, Comptroller 408
Memorandum dated May 15, 1987, to John Shad, Commissioner, SEC, from Annette Poulsen, Office of the Chief Economist 478
American Bar Association, comments on S. 1323 492
U.S. Securities and Exchange Commission, comments on Two-Tier Tender Offers, by Joseph A. Grundfest, Commissioner 520

Additional material relative to this hearing can be found in the following publications:

- Cornell Law Review, Vol. 72, Nov. 1986, No. 1.
- Harvard Law Review, Vol. 94, Apr. 1981, No. 6.
- Harvard Law Review, Vol. 98, June 1985, No. 8.
- Michigan Law Review, Vol. 85, Oct. 1986, No. 1.
- Northwestern Law Review, Vol. 76: 980, No. 6.
- Stanford Law Review, Vol. 33: 773, May 1981.
- Vanderbilt Law Review, Vol. 35, Nov. 1982, No. 6.
- Yale Law Journal, Vol. 96, Dec. 1986, No. 2.

REGULATING HOSTILE CORPORATE TAKEOVERS

TUESDAY, JUNE 23, 1987

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 9:30 a.m., in room SD-538, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Riegle, Dixon, Sasser, Sanford, Shelby, Graham, Wirth, Armstrong, D'Amato, Hecht, and Bond.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. Welcome to this first in a series of three hearings on proposed legislation regarding takeovers.

Today, we are pleased to hear from Beryl Sprinkel, Chairman of the Council of Economic Advisers, who will represent the views of the Reagan administration; and from Charles Cox, Commissioner of the Securities and Exchange Commission. Following this is a distinguished panel of State officials.

Tomorrow we will hear from the investment banking community and labor representatives, and on June 25 we will hear from corporate managers and shareholder groups. Collectively, their views are instrumental in making sure the bill crafted by this committee is effective and reponsible.

There are several bills before us. On June 4, 1987, I joined with nine committee colleagues to introduce S. 1323, the Tender Offer Disclosure and Fairness Act. It is a moderate bill, based primarily on fuller and more timely disclosure, but I think it should be strengthened, especially in the treatment of hostile takeover financing, as these hearings and the ongoing insider trading investigations I believe will demonstrate.

Also before the committee is the Corporate Takeover and Insider Abuse Reform Act submitted by Senator Sanford and the Tender Offer Reform Act submitted by Senator D'Amato.

[Copies of proposed bills follow:]

II

100TH CONGRESS
1ST SESSION

S. 227

To amend the Securities Exchange Act of 1934 to impose additional restraints on corporate tender offers, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 6, 1987

Mr. D'AMATO introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

To amend the Securities Exchange Act of 1934 to impose additional restraints on corporate tender offers, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. This Act may be cited as the "Tender Offer Reform Act of 1987".

SEC. 2. (a) Section 13(d)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(1)) is amended—

(1) by striking out "shall, within ten days after such acquisition, send" and inserting in lieu thereof "shall cease to acquire additional shares of such class until the expiration of two business days after such ac-

quisition (or such shorter period as the Commission may prescribe pursuant to paragraph (7)), and shall, within twenty-four hours after such acquisition, make a public announcement of such acquisition and send"; and

(2) by adding at the end thereof the following:

"The public announcement required to be made within twenty-four hours of an acquisition described in this paragraph shall include disclosure of the purchaser's identity, the amount of securities of the class beneficially owned by the purchaser, the identity of the issuer of that class, a brief description of the purpose of such acquisition, and other information that the Commission may prescribe by rule, regulation, or order.".

(b) Section 13(d) of the Securities Exchange Act of 1934 is further amended by adding at the end thereof the following new paragraph:

"(7) The Commission, by rule, regulation, or order, in the public interest or for the protection of investors and taking into account the time required for the information filed to be properly disseminated, may reduce the time period during which any person subject to the requirements of paragraph (1) of this subsection is prohibited from acquiring ownership of any additional shares of the equity security that is the subject of the statement required by paragraph (1) and may, subject to such terms and conditions as may be prescribed therein, provide exemptions from that prohibition.".

SEC. 3. (a) Section 13(d)(3) of the Securities Exchange Act of 1934 is amended by inserting "voting," after "acquiring,".

(b) Section 13(g)(3) of the Securities Exchange Act of 1934 is amended by inserting "voting," after "acquiring,".

SEC. 4. (a) Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended—

(1) by striking out the heading of such section and inserting in lieu thereof the following:

"PROXIES AND TENDER OFFERS";

(2) by inserting "(A)" after "(1)" in subsection (d);

(3) by adding at the end of paragraph (1) of subsection (d) the following:

"(B) The person making an offer, request, or invitation subject to this paragraph shall prepare and furnish to security holders at the time the offer, request, or invitation is published, sent, or given to security holders a summary disclosure of—

"(i) the identity and background of such person and any affiliates or associates of that person participating in the offer, request, or invitation;

"(ii) the value of the offer, request, or invitation;

"(iii) the amount of such securities beneficially owned by the persons identified under clause (i);

"(iv) the source and amount of funds or other consideration used for the proposed acquisition of securities;

"(v) the purpose of the acquisition;

"(vi) any plans or proposals the person has regarding the future operations or structure of the issuer; and

"(vii) such additional information as the Commission may, by rule or regulation, prescribe as necessary in the public interest or for the protection of investors.

Such person shall make a public announcement if the person varies any of the terms required to be disclosed under this subparagraph before the expiration of the offer, request, or invitation.

"(C) The Commission may adopt such rules, regulations, and orders as may be necessary or appropriate in the public interest or for the protection of investors to—

"(i) implement the provisions or carry out the purposes of this paragraph;

"(ii) to define any term used in this paragraph;

"(iii) to exempt any person or transaction or class of persons or transactions, as not comprehended within the purposes of this paragraph, in whole or in part, either unconditionally or upon specific terms and conditions; or

"(iv) to prevent any person from evading or circumventing the provisions of this paragraph.";

(4) by striking out paragraphs (2) and (3) of subsection (d), by redesignating paragraph (4) of such subsection as paragraph (2), and by inserting after such redesignated paragraph (2) the following new paragraph:

"(3)(A) Any person making a tender offer for or a request or invitation for tenders of any and all of the outstanding shares of a class of voting securities shall hold such offer, request, or invitation open for a period of at least 30 calendar days from the date on which such offer, request, or invitation is first published, sent, or given to security holders. Any person making a subsequent tender offer, request, or invitation for tenders for any and all or less than all of the outstanding shares during the pendency of another tender offer, request, or invitation for tenders under this paragraph with respect to any of such shares shall hold such offer, request, or invitation open for a period of at least 20 calendar days except that the subsequent offer, request, or invitation shall not terminate before the 30th calendar day following the initial offer.

"(B) Any person making a tender offer or request or invitation for tenders for less than all the outstanding shares of a class of voting securities shall hold such offer, request, or invitation open for a period of at least 40 calendar days from the date on which such offer, request, or invitation is first published or sent or given to security holders. Any person making a subsequent tender offer, request, or invitation for tenders for any and all or less than all of the outstanding shares during the pendency of another tender offer, request, or invitation for tenders under this paragraph with respect to any of such shares shall hold such offer, request, or invitation open for a period of at least 30 calendar days, except that the subsequent offer, request, or invitation shall not terminate before the 40th calendar day following the initial offer, request, or invitation.";

(5) by redesignating paragraphs (5) through (8) of such subsection as paragraphs (4) through (7), respectively;

(6) by redesignating subsections (f) and (g) as subsections (k) and (l), respectively; and

(7) by inserting after subsection (e) the following new subsections:

"(f) During a tender offer for, or request or invitation for tenders of, any class of any equity security which is registered pursuant to section 12 of this title, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of this title, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940, other than an offer, request, or invitation by the issuer, it shall be unlawful for the issuer of such securities to enter into or amend, directly or indirectly, agreements containing provisions, whether or not dependent on the occurrence of any event or contingency, that increase, directly or indirectly, the current or future compensation of any officer or director, except that this provision shall not prohibit routine increases in compensation, or other routine compensation agreements, undertaken in the ordinary course of the issuer's business.

"(g) It shall be unlawful for an issuer to purchase, directly or indirectly, any of its securities at a price above the average market price of such securities during the 30 preceding trading days from any person who holds more than 5 percent of the class of the securities to be purchased and has held such securities for less than 6 months, unless such purchase has been approved by the affirmative vote of a majority of the aggregate voting securities of the issuer, or the issuer makes an offer to acquire, of at least equal value, to all holders of securities of such class and to all holders of any class into which such securities may be converted.

"(h) The Commission may, by rule, regulation, or order, in the public interest or for the protection of investors, provide exemptions, subject to such terms and conditions as may be prescribed therein, from any or all of the provisions of subsection (f) or (g).

"(i)(1) During any 12-month period beginning on the date on which a person first acquires beneficial ownership of 20 percent of a class of (A) equity securities of a corporation which is registered pursuant to section 12 of this title, (B) equities security of an insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of this title, or (C) equities security issued by a closed-end investment company registered under the Investment Company Act of 1940, or during any succeeding 12-month period, it shall be unlawful for any person to acquire, directly or indirectly, beneficial ownership of more than 2 percent of the outstanding shares of such a class of securities except by tender offer or request or invitation for tenders or by purchase from the issuer.

"(2) Paragraph (1) does not apply in any case where—

"(A) the acquisition is involuntary, including any acquisition by gift, inheritance, or bequest, or by such similar transaction as the Commission may, by rule, regulation, or order, prescribe;

"(B) the acquisition is pursuant to a statutory merger or consolidation consummated under the laws of the issuer's state of incorporation; or

"(C) the Commission, by rule or regulation, or by order upon application, conditionally or unconditionally exempts any person, security, or transaction, or any class or classes of persons, securities, or transactions, from the provisions of this subsection and any regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest and consistent with protection of investors and purposes fairly intended by the policy and provisions of this subsection.

"(3) In determining, for purposes of this subsection, any percentage of a class of any security, section 13(d)(3) shall apply and any person, in determining the amount of outstanding securities of a class of equity securities, may rely upon information set forth in the issuer's most recent report filed with the Commission pursuant to this Act which contains information concerning the amount of outstanding securities of such class of securities.

"(4) For purposes of paragraph (1), a person will not be deemed to beneficially own securities by virtue of participating in a syndicate or group formed for the purpose of the solicitation of any proxy, consent, or authorization pursuant to subsection (a).".

(b) Such section is further amended by adding at the end thereof the following:

"(j)(1) When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, voting, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a 'person' for purposes of subsections (d), (e), (f), (g), and (i) of this section.

"(2) For purposes of subsections (d), (g), and (i) of this section, in determining any percentage of a class of any security, such class shall be deemed to consist of the amount of the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the issuer or any subsidiary of the issuer.".

SEC. 5. None of the amendments made by this Act shall be construed to limit or condition the authority of the Securities and Exchange Commission, in the public interest or for the protection of investors, to supplement the proration, withdrawal, and minimum offering periods applicable to a tender offer or request or invitation for tenders.

SEC. 6. (a) The Comptroller General, in coordination and consultation with the Securities and Exchange Commission, the Federal Home Loan Bank Board, the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Savings and Loan Insurance Corporation, the Federal Deposit Insurance Corporation, the

Secretary of the Treasury, and the Secretary of Labor shall study the issuance of and investment in high yield, noninvestment grade bonds during the 5 years prior to the date of enactment of this Act, including—

(1) the identity and rating (as determined by Moody's, Standard and Poor's, or other nationally recognized bond rating house) of the issuers of these bonds;

(2) the identity of the major purchasers of these bonds, including but not limited to federally insured depository institutions;

(3) the percentage of the total amount of high yield, noninvestment grade bonds that are issued as a method of financing corporate takeovers;

(4) the identity of the purchasers including, but not limited to, federally insured depository institutions that invest in high yield, noninvestment grade bonds that are issued as a method of financing corporate takeovers;

(5) the purposes for which high yield, noninvestment grade bonds are issued other than for financing corporate takeovers;

(6) a summary and analysis of the adequacy of current State and Federal laws that regulate investment in high yield, noninvestment grade bonds, by in-

vestors including, but not limited to, federally insured depository institutions and pension funds; and

(7) a review of the impact of the issuance of and investment in high yield, noninvestment grade bonds upon corporate debt as it relates to Federal monetary policy.

(b) In addition to the collection of information through surveys, public document review, interviews, and other information-gathering methods, at least one joint public hearing shall be held during the course of conducting the study.

(c) The Comptroller General shall transmit a report containing the results of the study under this section to the Congress not later than 120 days after the date of enactment of this Act.

○

II

100TH CONGRESS
1ST SESSION

S. 678

To amend the Securities Exchange Act of 1934 with respect to tender offers, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 6, 1987

Mr. METZENBAUM introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

To amend the Securities Exchange Act of 1934 with respect to tender offers, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Corporate Takeover Reform Act of 1987".

CHANGE OF 13(D) THRESHOLD AND 10–DAY WINDOW

SEC. 2. Section 13(d)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(1)) is amended by striking out "5 per centum of such class shall, within ten days" and inserting in lieu thereof "3 per centum of such class shall, within one day".

TWO-TIER, PARTIAL, AND "CREEPING" TENDER OFFERS

SEC. 3. Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended by adding at the end thereof the following:

"(h)(1) It shall be unlawful for any person, by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, to acquire, or agree to acquire, directly or indirectly, the beneficial ownership of any equity security of a class which is registered pursuant to section 12 of this title, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of this title, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940, if, after consummation thereof, such person would be, directly or indirectly—

"(A) the beneficial owner of the shares entitled to vote more than 15 per centum but less than 35 per centum of the votes that all holders of outstanding voting securities would be entitled to cast at an election of directors, unless the acquisition is made pursuant to a tender offer, or a request or invitation for tenders, open to all holders of the class of securities subject to the tender offer; or

"(B) the beneficial owner of more than 35 per centum of the votes that all holders of outstanding voting securities would be entitled to cast at an election of directors, unless—

"(i) such acquisition is made pursuant to a tender offer for, or a request or invitation for tenders of, all of the outstanding voting securities of the issuer, for the same price per share as all other shares acquired pursuant to the offer, to the holders of all outstanding shares of the class; or

"(ii) such acquisition is made pursuant to a tender offer for, or a request or invitation for tenders of, fewer than all of the outstanding voting securities of the issuer, and any shares not purchased pursuant to the offer, request, or invitation will be purchased within 6 months at a value equal to the price to be paid pursuant to the offer. The value of any securities offered as consideration for such shares shall be established by agreement of representatives of the issuer and the offeror, or, in the event of a disagreement, by a third party chosen by the issuer and the offeror. In the event an agreement has not been reached or a third party has not been appointed within 4 months after the acquisition of securities pursuant to the tender offer, the parties shall apply to the chief judge of the circuit which includes the State in which the issuer is located for appointment to a third party, and such appointment shall be made within 15 days of such application.

"(2) Subparagraphs (A) and (B) of paragraph (1) do not apply in any case where—

"(A) the person acquiring the securities is the issuer of such securities;

"(B) the acquisition is by gift, inheritance, or transfer from an existing holder to an individual related to such holder by blood or marriage, providing that the Commission may, by rule, regulation, or order, exempt acquisitions by gift to any person;

"(C) the acquisition is made in connection with the solicitation of a proxy, consent, or authorization pursuant to subsection (a);

"(D) the acquisition is by an employee benefit plan or pension fund of such issuer; or

"(E) on the effective date of this subsection such person is the beneficial owner of more than the applicable percentage of the outstanding voting equity securities of the issuer referred to in one of such subparagraphs and the acquisition would not represent an increase in the percentage of such person's beneficial ownership from the effective date of this subsection.".

WAITING PERIOD

SEC. 4. Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended—

(1) by striking out subsection (d)(2) and inserting in lieu thereof the following:

"(2) Any person making a tender offer or request or invitation for tenders shall hold such offer, request, or invitation open for a period of at least 60 days from the date on which such offer, request, or invitation is first published or sent or given to security holders, except that this paragraph shall not apply to such an offer, invitation, or request by the issuer for the class of securities being sought if such offer, invitation, or request is not made in anticipation of or response to another person's offer, request, or invitation for securities of the same class."; and

(2) by adding at the end thereof the following:

"(i)(1) For the purpose of subsections (d), (f), and (h), of this section, when two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, voting, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a 'person'.

"(2) For the purpose of this section, the term 'voting equity security' means any equity security of the issuer that entitles the holder thereof to vote generally in an election of directors of the issuer.".

DEFENSIVE TACTICS

SEC. 5. Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended by adding at the end thereof the following:

"(j)(1) An issuer which is the target of a takeover bid may not, from the time the takeover bid is publicly announced until the bid expires or otherwise terminates, enter into any transaction or take any action which constitutes a structural change, unless the change is pursuant to a contract entered into prior to any publicly announced takeover bid, or unless the change is approved by the holders of either a majority of the outstanding voting equity securities, or such greater number of holders as may be required by applicable State law, and on such minimum notice as may be prescribed by State law.

"(2) For the purpose of this subsection—

"(A) a takeover bid is publicly announced if a tender offer has been made for voting equity securities of the target company, or if any person states an intent to acquire control of a company in a statement filed with the Commission pursuant to section 13(d)(1) of this title; and

"(B) the term 'structural change' means—

"(i) any acquisition or disposition of any significant amount of assets other than in the ordinary course of business, any issuance or purchase of 5 per centum or more of any class of equity securities, or any agreement or arrangement for any of the foregoing,

"(ii) any other transaction or action which is reasonably likely to affect the voting rights of any class of securities of the company, or

"(iii) any other transaction or action which the Commission determines, by rule, regulation, or order, should be conditioned on shareholder approval in order to carry out the purpose of this subsection.

The Commission may, by rule, regulation, or order, exempt any transaction or action, unconditionally or on specified terms or conditions, as not constituting a structural change.".

"POISON PILLS"

SEC. 6. Section 14 of the Securities Exchange Act of 1934 is amended by adding at the end thereof the following:

"(k)(1) Not later than 180 days after the date of enactment of this subsection, the Commission shall issue rules or regulations which make it unlawful for an issuer which has a class of equity securities registered pursuant to section 12 of this title, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of this title, or which is a closed-end investment company registered under the Investment Company Act of 1940, to grant voting power or to issue any securities if such grant or issuance would—

"(A) entitle the holder of such voting power or securities to purchase at less than market value securities of a corporation other than the issuer or securities of the successor to such a corporation;

"(B) entitle the holder of such securities to purchase at less than market value any securities of the issuer; or

"(C) require the issuer to repurchase its securities from its holders at greater than market value;

where such entitlement or requirement is conditioned upon a change in control of the issuer, or the acquisition of securities by a third party, or may be invoked only during the pendency of a tender offer or other contest for control of the issuer.

"(2) For the purpose of this subsection, a grant or issuance by or for the issuer, or any person controlling, controlled by, or under common control with the issuer, or a grant or issuance subject to control of the issuer or any such person, shall be deemed to be a grant or issuance by the issuer.

"(3) The Commission, in the public interest and for the protection of investors, is authorized to issue rules and regulations implementing this subsection, including exemptive rules and regulations covering situations in which the Commission deems it unnecessary or inappropriate that a grant or issuance of the type described in this subsection shall be deemed to be a grant or issuance by the issuer for purposes of some or all of the provisions of paragraph (1) of this subsection.".

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II

100TH CONGRESS
1ST SESSION

S. 1264

To place a moratorium on hostile foreign takeovers.

IN THE SENATE OF THE UNITED STATES

MAY 21 (legislative day, MAY 13), 1987

Mr. SANFORD (for himself, Mr. PRYOR, Mr. SASSER, Mr. FOWLER, and Mr. TRIBLE) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To place a moratorium on hostile foreign takeovers.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as "The Hostile Foreign Takeover Moratorium Act."

SEC. 2. FINDING.

The financing of transactions to acquire control of United States corporations through tender offers and other forms of business acquisitions often involves loans, borrowings, or the issuance of debt securities or other obligations, secured directly or indirectly, by the assets of the United

States corporations proposed to be acquired, or expected to be paid in substantial part, directly or indirectly, from the sale of the assets of the United States corporations proposed to be acquired, which makes surviving corporations more vulnerable to foreign and domestic competitors, and can result in loss of jobs and massive dislocations to local and regional economies and to the national economy in general.

SEC. 3. TAKEOVERS: PROHIBITIONS.

Section 14 of the Securities and Exchange Act of 1934 is amended by adding at the end thereof a new section:

"(h)(1) Until six months after the date of enactment of this Act, it shall be unlawful to make, continue, or consummate, or acquire shares pursuant to, a tender offer for, or a request or invitation for tenders of, any equity securities by any person who is a foreign person on the date of introduction of this Act—

"(A) if any part of the consideration to be paid for any such equity security pursuant to such tender offer is cash, unless such person has or had in his possession, at the time of the commencement of the tender offer, cash or cash equivalents equal to the aggregate amount of such cash consideration or legally binding commitments in customary form to provide such cash consideration from recognized financial institutions or a combination of the foregoing; or

"(B) if any part of the consideration to be paid for any such equity security pursuant to such tender offer is to be financed by means of a loan, borrowing or issuance of debt securities, or other obligation to pay money or money's worth.

"(2) The prohibitions contained in this subsection shall not apply if the acceptance of such offer has been recommended and approved by the directors (or persons performing a similar function) of the person to be acquired by the tender offer.

"(3)(A) 'Foreign person' means any person which is not a citizen of the United States, or any person the ultimate parent of which is owned or controlled by any person which is not a citizen of the United States.

"(B) A person or parent is 'controlled' by another person, if the second person directly or indirectly or acting through one or more other persons (i) holds 25 per centum or more of the outstanding voting securities of the person or parent; (ii) holds securities of the person or parent equaling in face value, liquidation preference, book value or market value, whichever is higher, 25 per centum or more of the book value of the assets of such person or parent; (iii) has contractual or other power, whether contingent or otherwise, to designate a majority of the directors (or persons having a similar function) of the person or parent; or (iv) has the power to veto, or has the right of prior approval of, material actions or omissions of the person or parent. Without limiting the generality of the foregoing, for purposes of this Act, a partnership shall be deemed to be controlled by each of its general partners, and by any limited partner that has any rights referred to in clause (iv) of this definition.

"(C) 'Person' means any corporation, partnership, limited partnership, syndicate, business trust, association or similar organization, or other group, or any two or more persons acting in concert or in a coordinated or consciously parallel manner (whether or not by express agreement).

"(4) The Commission is authorized to enforce the provisions of this Act in proceedings under section 27 of the Securities and Exchange Act of 1934.

"(5) This Act shall be effective with respect to any tender offer commenced or to be consummated after the date of introduction of this Act by any person who is a foreign person on the date of introduction of this Act"."

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II

100TH CONGRESS
1ST SESSION

S. 1323

To amend the Securities Exchange Act of 1934 to provide to shareholders more effective and fuller disclosure and greater fairness with respect to accumulations of stock and the conduct of tender offers.

IN THE SENATE OF THE UNITED STATES

JUNE 4, 1987

Mr. PROXMIRE (for himself, Mr. RIEGLE, Mr. CRANSTON, Mr. SARBANES, Mr. DODD, Mr. DIXON, Mr. SASSER, Mr. SANFORD, and Mr. WIRTH) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To amend the Securities Exchange Act of 1934 to provide to shareholders more effective and fuller disclosure and greater fairness with respect to accumulations of stock and the conduct of tender offers.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Tender Offer Disclosure and Fairness Act of 1987".

SEC. 2. FINDINGS AND PURPOSES.

(a) FINDINGS.—The Congress finds that—

(1) under the laws as they exist, investors have not received timely, adequate, or sufficient information with respect to accumulations of securities in the market and with respect to conduct involved in tender offers or otherwise;

(2) investors have been denied fair treatment in the course of tender offers;

(3) private investors and issuers have been denied the opportunity to secure relief when they have been harmed or may be harmed by violations of the disclosure and fairness provisions of the law in the course of tender offers;

(4) the integrity of financial markets and the confidence of the public in them, which are essential to the economic welfare of the country, have been undermined by the conduct of parties in tender offers; and

(5) certain individuals and entities have sought to precipitate, intensify, and prolong speculation in connection with acquisitions or proposed acquisitions of corporations to the detriment of corporations and their shareholders—

(A) by engaging in acts and practices designed to circumvent the equal treatment of all shareholders;

(B) by failing to disclose the nature and extent of their speculative activities; and

(C) by acting in concert with others to further the common objective of speculation in the market for control.

(b) PURPOSES.—Therefore, in order to protect the public interest, the purposes of this Act are to foreclose the opportunities for abuse under the present provisions of law and to expand the protective mechanisms of the Federal securities laws.

SEC. 3. 10-DAY WINDOW; CONTENTS OF REPORT.

(a) Section 13(d)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(1)) is amended—

(1) by striking out "5" and inserting in lieu thereof "3"; and

(2) by striking out "within ten days after such acquisition" and inserting in lieu thereof "not later than the close of business on the next trading day after such acquisition".

(b) Section 13(d)(1)(A) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(1)(A)) is amended by inserting before the semicolon at the end thereof the following: "and, if within 90 days preceding the acquisition, such filing person has had communications regarding his intention to purchase the securities which are the subject of such filing person's statement with any other person (i) who has filed a statement pursuant to this section or pursuant to section 13(g) of this title, or (ii) who, to the knowledge of such filing person, as a result of such communications, acquired or agreed to acquire any equity securities of the same class as those subject to the filing person's statement, the background, identity, residence, and citizenship of such other person, and the fact of each such communication and the date thereof but not otherwise including the content of such communications".

(c) Section 13(d)(1)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(1)(B)) is amended by striking out "security, a description of the transaction and the names of the parties thereto, except that where a source of funds is a loan made in the ordinary course of business by a bank, as defined in section 3(a)(6) of this title, if the person filing such statement so requests, the name of the bank shall not be made available to the public" and inserting in lieu thereof the following: "security—

"(i) a summary of each agreement or arrangement relating to the extension of credit, the issuance of securities for cash, or the other acquisition of such funds, including the identity of the parties, the term, the collateral, the stated and effective interest rates, all fees to be paid to any person in connection with the agreement or arrangement, and all other material terms or conditions relative to such loan agreement or arrangement; and

"(ii) any plans or arrangements to finance or repay any amount of such funds representing indebtedness incurred or to be incurred, or if no such plans or arrangements have been made, a statement to that effect".

(d) Section 13(d)(1)(C) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(1)(C)) is amended by inserting before the semicolon at the end thereof the following: ", and the Commission shall prescribe, in the rules and regulations governing the contents of such statement, the means by which such statement would be required to designate whether the purpose of the person filing such statement (i) is to acquire, or influence, the control of the issuer, including having the effect of permitting any other person to acquire or influence such control, or (ii) is only for investment, without any purpose or effect of changing or influencing the control of the issuer, including participating in any transaction having such purpose or effect".

(e) Section 13(d)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(1)) is amended—

(1) by striking out "and" at the end of subparagraph (D);

(2) by striking out the period at the end of subparagraph (E) and inserting in lieu thereof "; and"; and

(3) by adding at the end thereof the following:

"(F) a reasonably itemized statement of all expenses incurred or estimated to be incurred in connection with the acquisition of such beneficial ownership, including filing fees, legal, accounting, financial advisory, and investment banking fees and similar fees and expenses indicating whether or not such person has paid or will be responsible for paying any or all such expenses.".

(f) Section 13(d)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(1)) is amended by adding at the end thereof the following:

"Any person required to send and file such a statement may not acquire or agree to acquire, directly or indirectly, the beneficial ownership of any additional amount of such equity securities after the transaction that required such person to send and file such statement until after such statement has been filed with the Commission and an announcement has been publicly disseminated in the manner and containing such of the material information disclosed in such statement, as the Commission by rule or regulation may prescribe.".

SEC. 4. TIME FOR FILING AMENDMENTS.

Section 13(d)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(2)) is amended by inserting after "shall be filed with the Commission" the following: "not later than the close of business on the next trading day after such change occurs".

SEC. 5. ENFORCEMENT MEASURES.

Section 13(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)) is amended—

(1) by striking out paragraph (6)(B), and by redesignating paragraphs (6)(C) and (6)(D) as paragraphs (6)(B) and (6)(C), respectively;

(2) by striking out paragraph (3) and inserting in lieu thereof the following:

"(3) For purposes of this subsection, the term 'person' shall include two or more persons acting in concert or in a coordinated or consciously parallel manner (whether or not pursuant to an express agreement) or as a partnership, limited partnership, syndicate, or other group (whether or not formally organized) for the purpose of acquiring, holding, or disposing of securities of an issuer, or influencing the management or policies of an issuer."; and

(3) by redesignating paragraphs (4) through (6) as paragraphs (6) through (8), and by inserting after paragraph (3) the following:

"(4) It shall be unlawful for any person who has disclosed in any statement required to be filed under this subsection or any amendment thereto that the acquisition of securities is for investment purposes, by making a designation of purpose pursuant to paragraph (1)(C)(ii) of this subsection, to acquire by tender offer or request or invitation for tenders, directly or indirectly, beneficial ownership of any additional shares of the class of equity security that is the subject of the statement required by this subsection until 6 months after the date an amendment is filed under paragraph (2) of this subsection disclosing that the purpose of the purchases or prospective purchases is to obtain or influence the control of the issuer of such securities unless such person can demonstrate to the Commission that there has been a material change of circumstances which resulted in a change in the purpose for which such securities are held or were acquired. The Commission shall have the power, by order, upon application, and after notice and opportunity to participate are given to interested persons, to grant exemptions from the prohibition of this paragraph upon the applicant's making such a demonstration.

"(5) It shall be unlawful for any person to make any false statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any statement required to be filed under this subsection. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.".

SEC. 6. CIVIL LIABILITY.

Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended by adding at the end thereof the following:

"(i)(1) The issuer of the securities in question or any other person aggrieved in his business or property by reason of any violation of section 7 of this title or the rules or regulations thereunder in connection with the financing of a tender offer, a request or invitation for tenders, or other acquisition of equity securities in an effort to obtain or influence the control of an issuer, or by reason of a violation of subsection (d), (f), or (g) of this section or the rules and regulations thereunder, including but not limited to any false statement of material fact or omission of a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading, may bring suit in any court of competent jurisdiction, without respect to the amount in controversy, to recover actual damages sustained by that person, and the cost of the suit, including reasonable attorney's fees, and to seek such equitable relief as the court deems proper to carry out the purposes of those sections, including an order enjoining any person violating any such provision of those sections from voting securities acquired in connection with such violation, an order to compel divestiture of such securities, or an order enjoining the making of any tender offer or other effort to acquire control for such period of time as the court may order. The provisions of sections 18(b) and 18(c) of this title shall be applicable to any such action seeking monetary damages.

"(2) A person shall not be liable for monetary damages under this subsection for a violation which resulted from a bona fide error notwithstanding the maintenance of, and compliance with, procedures reasonably necessary to prevent such violations.".

SEC. 7. TENDER OFFERS.

(a) Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended by striking out the heading of such section and inserting in lieu thereof the following:

"PROXIES AND TENDER OFFERS".

(b) Section 14(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(d)) is amended—

(1) by striking out paragraph (2);

(2) by redesignating paragraphs (3) through (8) as paragraphs (5) through (10); and

(3) by inserting after paragraph (1) the following:

"(2) Any person making a tender offer for, or a request or invitation for tenders of, shares of any class of any such equity security shall hold such offer, request, or invitation open for a period of at least 35 business days from the date on which such offer, request, or invitation is first published, sent, or given to security holders, or such longer period as the Commission may, by rule or regulation, prescribe.

"(3) For purposes of this subsection, the term 'person' shall include two or more persons acting in concert or in a coordinated or consciously parallel manner (whether or not pursuant to an express agreement) or as a partnership, limited partnership, syndicate, or other group (whether or not formally organized) for the purpose of acquiring, holding, or disposing of securities of an issuer, or influencing the management or policies of an issuer.

"(4)(A) It shall be unlawful for any person by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, to acquire, or agree to acquire, directly or indirectly, any shares of any class of any equity security described in paragraph (1) of this subsection, if such person is, or after consummation of such acquisition would become, directly or indirectly, the beneficial owner of more than 15 per centum of such class unless such acquisition is made pursuant to a tender offer, or a request or invitation for tenders, subject to the provisions of this section and the rules and regulations thereunder.

"(B) The Commission shall by rule, or by order upon application, conditionally or unconditionally exempt any person, security, or transaction from the provisions of this paragraph, to the extent that such exemption is necessary or appropriate in the public interest and for the protection of investors, and consistent with the purposes and policy fairly intended by this paragraph.".

(c) Section 14(d)(8) of such Act, as redesignated by subsection (a), is amended by striking out "paragraph (7)" in the last sentence and inserting in lieu thereof "paragraph (9)".

SEC. 8. ACTIONS BY ISSUERS.

Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended by adding at the end thereof the following:

"(h)(1) It shall be unlawful for an issuer of securities described in subsection (d)(1) to purchase, directly or indirectly, any of its securities at a price above the market value of such securities from any person who holds more than 3 percent of the class of the securities to be purchased and has held such securities for less than 6 months, unless such purchase has been approved by the affirmative vote of a majority of the aggregate outstanding voting securities of the issuer, or the issuer makes an offer, of at least equal value per share, to all holders of securities of such class and to all holders of any class into which such securities may be converted. For the purpose of this subsection, the market value of such securities shall be the average market price of such securities during the 30 trading days preceding a purchase of securities subject to this subsection, provided that, if such person has commenced a tender offer or has announced an intention to seek control of the issuer, such average market price shall be determined during the 30 trading days preceding the commencement of such tender offer or the making of such announcement.

"(2) During a tender offer for, or request or invitation for tenders of, any class of equity security described in subsection (d)(1), other than an offer, request, or invitation by the issuer, it shall be unlawful for the issuer of such securities to enter into or amend, directly or indirectly, agreements containing provisions, whether or not dependent on the occurrence of any event or contingency, that increase, directly or indirectly, the current or future compensation of any officer or director, except that this provision shall not prohibit routine increases in compensation, or other routine compensation agreements, undertaken in the ordinary course of the issuer's business.

"(3) The Commission may, by rule, regulation, or order, in the public interest or for the protection of investors, provide exemptions, subject to such terms and conditions as may be prescribed therein, from any or all of the provisions of paragraph (1) or (2).

"(i) An issuer of equity securities described in subsection (d)(1) which are the subject of a tender offer, or a request or invitation for tenders, may not from the time the tender offer or request or invitation is commenced until such offer or request or invitation expires or otherwise terminates, grant, declare, or establish any rights to acquire any securities, if such rights would—

"(1) entitle the holder of such rights to purchase at less than market value securities of a corporation other than the issuer or securities of the successor to such a corporation; or

"(2) entitle the holder of such rights to purchase at less than market value any securities of the issuer;

where such entitlement or requirement is conditioned upon a change in control of the issuer, or the acquisition of securities by a third party, or may be invoked only during the pendency of a tender offer or other contest for control of the issuer. The Commission may by rule or regulation, or by order upon application, conditionally or unconditionally exempt any person, security, or transaction from the provisions of this paragraph to the extent that such exemption is necessary or appropriate in the public interest and for the protection of investors and consistent with the purposes and policy fairly intended by this paragraph.".

SEC. 9. REGISTRATION AND REGULATION OF ARBITRAGEURS.

(a) Section 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(5)) is amended—

(1) by inserting "(A)" after "means"; and

(2) by striking out "otherwise, but" and inserting in lieu thereof "otherwise, and (B) a tender offer arbitrageur. Such term".

(b) Section 3(a) of such Act (15 U.S.C. 78(c)) is amended by inserting before paragraph (48) the following:

"(47) The term 'tender offer arbitrageur' means any person who regularly buys and sells, for its own account or for the account of others, in response to, or in anticipation of, a merger, tender offer, recapitalization, restructuring, or other similar transaction, equity securities of classes that are registered pursuant to section 12 of this title, equity securities of insurance companies that would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of this title, or equity securities issued by closed-end investment companies registered under the Investment Company Act of 1940. The term 'tender offer arbitrageur' does not include any natural person; any issuer, including a separate account, that is registered under the Investment Company Act of 1940; any 'employee benefit plan' subject to section 401 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1101); or any person, or class of persons, that the Commission may, by rule or order, as it deems consistent with the public interest and the protection of investors, either conditionally or upon specified terms and conditions or for stated periods, exempt from this definition of 'tender offer arbitrageur'.".

(c)(1) The amendments made by subsections (a) and (b) of this section shall take effect 180 days after the date of enactment of this Act.

(2) No person may continue to act as a tender offer arbitrageur within the meaning of the amendments made by subsections (a) and (b) of this section after the expiration of 270 days after the date of enactment of this Act unless such person has been registered with the Commission as required by the amendment made by subsection (a).

SEC. 10. ERISA AMENDMENT.

(a) Section 409 of the Employee Retirement Income Security Act (29 U.S.C. 1109) is amended by adding at the end thereof the following:

"(c) Notwithstanding any other provision of this title, no fiduciary to which a tender offer or exchange offer is made pursuant to section 14(d) of the Securities Exchange Act of

1934 (15 U.S.C. 78n(d)(1)), shall be liable under this section or section 405 for any decision not to tender securities held in trust by an employee benefit plan subject to this title in the absence of gross negligence or willful malfeasance if the decision not to tender is made by a fiduciary who does not have interests in the transaction that are adverse to the interests of the plan participants and beneficiaries.".

(b) Section 405(a) of such Act (29 U.S.C. 1105(a)) is amended by inserting after "part" the following: ", except as otherwise provided in section 409(c),".

(c) Section 4404 of such Act (29 U.S.C. 1344) is amended by adding at the end thereof the following new subsection:

"(e)(1) Notwithstanding subsection (d)(1), a distribution otherwise permitted pursuant to such subsection shall be prohibited if any part of the residual assets of the plan are used to finance, directly or indirectly, any acquisition of the securities of the employer pursuant to a tender offer subject to section 14(d) of the Securities Exchange Act of 1934 (12 U.S.C. 78n(d)) (or which would be subject to such provisions except for the exemption provided in paragraph (8)(B) of such section) by any person, including the repayment, redemption, or refinancing of any indebtedness incurred by such person in connection with any such acquisition.

"(2) For purposes of this subsection:

"(A) The term 'person' means a natural person, company, or partnership including an employer, two or more persons acting in concert or in a coordinated or consciously parallel manner (whether or not pursuant to an express agreement) or as a partnership, limited partnership, syndicate, corporation, or other group (whether or not organized) for the purpose of acquiring, holding, or disposing of the securities of the employer, or influencing the management or policies of the employer.

"(B) The term 'employer' includes any person that, directly or indirectly, owns or controls 50 percent or more of the voting power or total value of the outstanding stock of an employer.".

SEC. 11. INCREASED PENALTIES FOR INSIDER TRADING, PERJURY, AND OBSTRUCTION OF JUSTICE.

Section 32 of the Securities Exchange Act of 1934 (15 U.S.C. 78ff) is amended by adding at the end thereof the following:

"(d) Any person who willfully violates section 10(b) of this title or the rules and regulations thereunder by purchasing or selling a security while in the possession of material nonpublic information, in a transaction on or through the facilities of a national securities exchange or from or through a broker or dealer, but not including transactions which are part of a public offering by an issuer of securities other than standardized options, shall upon conviction be fined not more than $1,000,000, or imprisoned not more than 10 years, or both.

"(e) Any person who willfully in the course of an investigation of a violation of this title relating to the purchasing or selling of a security while in the possession of material nonpublic information violates section 1505, 1510, 1621, or 1622 of title 18, United States Code, shall upon conviction be imprisoned for one year which shall be in addition to and served consecutively to any other term of imprisonment for the violation.".

SEC. 12. ROLE OF STATE LAW.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by adding at the end thereof the following:

"ROLE OF STATE LAW

"SEC. 36. The Congress declares that the internal affairs or governance of corporations shall be subject to regulation by the laws of the State under which such corporation is organized. Nothing contained in section 13 or 14 of this title or any rules or regulations thereunder shall be construed to invalidate, impair, or supersede any law enacted by any State regulating the internal affairs or governance or contests for control of any corporation organized under its laws, except where compliance with such law would preclude compliance with the filing, disclosure, procedural, or antifraud requirements of sections 13 and 14 of this title.".

II

100TH CONGRESS
1ST SESSION

S. 1324

To amend the Securities Exchange Act of 1934 to provide for more effective disclosure and to curb abuses with respect to accumulations of stock and the conduct of tender offers.

IN THE SENATE OF THE UNITED STATES

JUNE 4, 1987

Mr. SANFORD introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To amend the Securities Exchange Act of 1934 to provide for more effective disclosure and to curb abuses with respect to accumulations of stock and the conduct of tender offers.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Corporate Takeover and Insider Abuse Reform Act of 1987".

SEC. 2. FINDINGS.

The Congress finds that—

(1) many corporate takeovers, and the huge debt incurred to finance them, have resulted in the forced

and rapid restructuring of many of America's businesses, have caused the elimination of thousands of jobs as well as severe economic dislocation in numerous communities;

(2) many healthy and efficiently run companies have been subject, without adequate warning, to destructive corporate takeovers;

(3) on an aggregate basis, corporate takeovers have been a factor in an enormous increase in corporate debt—the average ratio of corporate long-term debt to equity based on market values has increased from 35.3 per centum in 1961, to 46.7 per centum in 1971, to 71.4 per centum in 1986;

(4) the increasing debt could have serious economic ramifications in the event of recession or an interest rate spiral;

(5) these destructive corporate takeovers have been in part facilitated by inadequacies in our existing securities laws;

(6) under the existing law, corporations do not receive adequate or timely notice of a takeover attempt, while the actual tender offer period is too short for the corporation and its shareholders to reasonably evaluate the offer;

(7) due to inadequacies in the law, groups of investors and others acting in concert can actually own a majority of a corporation's stock before management and other shareholders are notified;

(8) many takeover attempts are initiated so that management will buy back stock at a high premium over the market price, thereby discriminating against long-term shareholders and contributing to the corporation's debt burden;

(9) the large amount of debt incurred by corporations either as a result of, or to stave off takeovers has resulted in a decrease in research and development budgets and needed investments in plant improvements and equipment at a time when United States industry is struggling to maintain its international competitiveness;

(10) corporations with well-funded employee pension funds have become targets of takeovers and such pensions funds have been used to pay for takeovers once they are consummated;

(11) the enormous amounts of money involved in corporate takeovers, as well as the necessity to accumulate large amounts of stock quickly, has been one of the factors leading to profiteering by insiders;

(12) the integrity of financial markets and the confidence of the public in them have been undermined by the conduct of parties in tender offers; and

(13) therefore, in order to protect the public interest, it is necessary to correct inadequacies in, and curb abuses of, our existing securities laws.

SEC. 3. TEN-DAY WINDOW: FILING REQUIREMENTS.

(a) Section 13(d)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(1)) is amended—

(1) by striking out "5" and inserting in lieu thereof "2.5"; and

(2) by striking out "; within ten days after such acquisition," and inserting in lieu thereof "cease to acquire additional shares of such class until the expiration of two business days after such acquisition (or such shorter period as the Commission may by rule prescribe), and shall, no later than the first business day after initially acquiring such direct or indirect beneficial ownership, make a public announcement of such acquisition and".

(b) Section 13(d)(1)(A) of the Securities Exchange Act of 1934 is amended by adding at the end thereof the following: "and the background, identity, residence, and citizenship of any other person to whom such purchases have been disclosed or discussed".

(c) Section 13(d)(1)(B) of the Securities Exchange Act of 1934 is amended by striking out "security, a description of the transaction and the names of the parties thereto, except that where a source of funds is a loan made in the ordinary course of business by a bank, as defined in section 3(a)(6) of this title, if the person filing such statement so requests, the name of the bank shall not be made available to the public;" and inserting in lieu thereof the following:

"security—

"(i) a summary of each agreement or arrangement relating to the extension of credit, issuance of securities for cash or other acquisition of such funds, including the identity of the parties, the term, the collateral, the stated and effective interest rates, all fees to be paid to any person in connection with such an agreement or arrangement and all other material terms or conditions relative to such loan agreement or arrangement; and

"(ii) any plans or arrangements to finance or repay any amount of such funds representing indebtedness incurred or to be incurred or if no such plans or arrangements have been made, a statement to that effect";

(d) Section 13(d)(1) of the Securities Exchange Act of 1934 is amended—

(1) by striking out "and" at the end of subparagraph (D);

(2) by striking out the period at the end of subparagraph (E) and inserting in lieu thereof"; and "; and

(3) by adding at the end thereof the following new paragraph:

"(F) the amount of any fees paid or proposed to be paid in connection with the purchases or prospective purchases, or in connection with the obtaining of funds representing any part of the purchase price or proposed purchase price, a description of the services rendered or proposed to be rendered in consideration of such fees, and the identity of any person to whom such fees have been or are proposed to be paid.".

SEC. 4. TIME FOR FILING STATEMENTS.

(a) Section 13(d)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(2)) is amended by inserting after the words "shall be filed with the Commission" the words "no later than the following business day."

(b) Section 13(d)(2) of the Securities Exchange Act of 1934 is further amended by adding at the end thereof the following new sentence: "For purposes of this subsection, the additional acquisition or disposition, directly or indirectly, of the beneficial ownership of 1 per centum or more of the class of equity security that is the subject of the statement required by paragraph (1) of this subsection shall be deemed material."

SEC. 5. REQUIREMENT TO FILE.

Section 13(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)) is further amended—

(a) by striking out paragraph (6)(B) of subsection (d), and by redesignating paragraphs (6)(C) and (6)(D) as (6)(B) and (6)(C), respectively;

(b) by striking paragraph (3) thereof and by inserting in lieu thereof the following:

"(3)(A) When two or more persons act as a partnership, limited partnership, syndicate, or other group (whether or not organized) for the purpose of acquiring, voting, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a 'person' for purposes of subsections (d), (e), and (g) of this section and subsections (d), (e), and (h) of section 14 of this title.

"(B) In making a determination under this paragraph, the Commission (or any court having jurisdiction)—

"(i) may rely on the extent to which the syndicate or group acted in a consciously parallel manner, without regard to the existence of a contract or agreement;

"(ii) shall consider actions taken by a person to conceal the beneficial ownership of the securities by depositing such securities with another person as evidence of the participation of both such persons in a group within the meaning of subparagraph (a); and

"(iii) may consider such other actions or circumstances as the Commission (or such court) considers relevant to the determination.".

(c) by inserting the following new paragraphs at the end of subsection (d):

"(7) It shall be unlawful for any person, who fails to file the statement or information required by this subsection, to acquire, directly or indirectly, beneficial ownership of any additional shares of the equity security that is the subject of the statement required by this subsection until such statement or information is filed.

"(8) It shall be unlawful for any person, who has not disclosed in any statement required to be filed under this subsection that the acquisition of securities is for the purpose of obtaining, or seeking to influence, control of the issuer, to acquire by tender offer or request or invitation for tenders, directly or indirectly, beneficial ownership of any additional shares of the class of equity security that is the subject of the statement required by this subsection during the six-month period beginning on the date an amendment is filed under paragraph (2) of this subsection disclosing that the purpose of the purchases or prospective purchases is to obtain control of the issuer of such securities.".

SEC. 6. CONFORMING AMENDMENT.

(a) Section 13(g)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(g)(1)) is amended by striking out "5" and inserting in lieu thereof "2.5";

SEC. 7. CIVIL LIABILITY.

Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended by adding at the end thereof the following new subsections:

"(i)(1) The issuer of the securities in question or any other person aggrieved in his business or property by reason of any violation of section 13(d), or 13(f) of this title, including, but not limited to, by any false statement of material fact or omission of a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading, may bring suit in any court of competent jurisdiction, without regard to the amount in controversy, to recover actual damages sustained by that person, and the cost of the suit, including reasonable attorney's fees, and seek such equitable relief, including, but not limited to, an order enjoining any person liable under this subsection from voting securities acquired in violation of the provisions of those sections or divestiture of such securities, or an order enjoining the making of any tender offer or other effort to acquire control for such period of time as the court may order, as the court deems proper to carry out the purposes of those sections.

"(2) In any action under this subsection alleging harm based on a misrepresentation or an omission of a material fact, or upon a failure to file a statement or provide information required by section 13(d), 13(g), or 13(f) of this title, it shall not be necessary in order to establish a cause of action for the person bringing suit, or on whose behalf suit is brought, to show reliance on the misrepresentation or omission. Such person may establish a cause of action on a showing that he did not have knowledge of the relevant facts as they should have been disclosed and that there is substantial likelihood that a reasonable investor would have considered the fact important in deciding how to act or that proper disclosure would have significantly altered the total mix of information available.

"(3) A person has no liability under this subsection for a violation which was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably necessary to prevent such violations.".

SEC. 8. CONFORMING AMENDMENT.

Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended by striking out the heading of such section and inserting in lieu thereof the following:

"PROXIES AND TENDER OFFERS"

SEC. 9. TENDER OFFERS.

(a) Section 14(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(d)) is amended—

(1) by redesignating paragraphs (2) through (8) as paragraphs (4) through (10) of such subsection, and by inserting the following new paragraphs:

"(2) Any person making a tender offer for or a request or invitation for tender offers of any class of any such equity security shall hold such offer, request, or invitation open for a period of at least forty-five business days from the date on which such offer, request, or invitation is first published, sent or given to security holders, or such longer period as the Commission may, by rule, prescribe.

"(3)(A) It shall be unlawful for any person by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, to acquire, or agree to acquire, directly or indirectly, any class of any such equity security if, after consummation thereof, such person would become, directly or indirectly, the beneficial owner of more than 20 per centum of such class, unless such acquisition is made, pursuant to a tender offer, or a request or invitation for tenders, which includes an offer under the same terms as the outstanding tender offer for all of the outstanding shares of such class (including all shares of such class issuable upon conversion or exercise of other outstanding securities, warrants, options or other rights issued or granted by the issuer).

"(B) It shall be unlawful for any person to acquire, directly or indirectly, the beneficial ownership of any covered equity security of a class, if after such acquisition such person will be the beneficial owner, directly or indirectly, of more than 10 per centum of such class, except by tender offer or request or invitation for tenders or by purchase from the issuer.

"(C) The provisions of subparagraph (A) shall not apply to any acquisition of any equity security approved in advance by the board of directors of the issuer thereof, or exempted by the Commission by regulation or order.

"(D) It shall be unlawful for any person, who has withdrawn or otherwise terminated any tender offer or request or invitation for tenders of any class of such equity security to acquire, directly or indirectly, beneficial ownership of any additional share of the class of equity security that was the subject of the tender offer or a request or invitation for tenders for a period of thirty calendar days from the date of such withdrawal or termination, or such other longer period as the Commission may, by rule, prescribe: *Provided, however,* That any acquisition made after the expiration of the thirty-day period shall be fully subject to the restrictions contained in paragraph (4) of this section."; and

(2) by adding at the end thereof the following:

"(11) Where any person makes a tender offer, such person shall provide to the Commission and the issuer of the securities within forty-eight hours of the making of the tender offer a statement—

"(A) specifying whether the acquiring person intends as a result of the acquisition—

"(i) to sell or close any facility, or

"(ii) to terminate or alter any operation, or

"(iii) to abide by the collective bargaining and other agreements of the person to be acquired;

"(B) estimates of the number of employment positions of the acquiring person and of the person to be acquired that are likely to be lost, in each year of the five-year period beginning on the date such acquisition is to be consummated, as a result of such acquisition;

"(C) estimates of the revenue likely to be lost, in each year of such five-year period, by each governmental entity in the geographical jurisdiction where the major facilities of the acquiring person or of the person to be acquired are located;

"(D) specifying the aggregate amount of the liabilities the acquiring person has, and the aggregate amount of equity the acquiring person has (in all assets in which the acquiring person has an interest) immediately before the acquiring person begins to carry out such acquisition;

"(E) specifying the aggregate amount of the liabilities the acquiring person is likely to have, and the aggregate amount of equity the acquiring person is likely to have (in all assets in which the acquiring person is likely to have an interest) after such acquisition is consummated;

"(F) specifying whether any assets of the person to be acquired are or are likely to be pledged, contracted to be pledged, treated as collateral or consideration, or used in any way (directly or indirectly) to obtain credit or financing to carry out such acquisition; and identifying each such asset; and

"(G) the background identity, and citizenship of any person to whom such plans or proposals have been disclosed or discussed.".

(b) Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended by adding at the end thereof the following new subsection:

"(h)(1) For the purpose of preventing the unfair making or threatening of a tender offer for an issuer's stock by persons who do not intend to complete or make a tender offer for, or change or influence the control of, the issuer, all profit (less reasonable expenses) realized by any person from any sale or other disposition of any equity security of an issuer within any period of less than six months after the date on which such person commenced a tender offer for, or made a request or invitation for tenders of, any class of equity security of such issuer or made a public announcement of an intention to make a tender offer for or otherwise seek control of such issuer, shall inure to and be recoverable by the issuer: *Provided, however,* That the provisions of this subsection shall not apply to any such sale or other disposition of any equity security of an issuer of which such person was the direct or indirect beneficial owner on or before the date six months prior to the date on which such person commenced such tender offer, requested or invited such tenders or made such announcement. This subsection shall not be construed to cover any transaction or transactions which the Commission by rules and regulations or, upon application, by order may exempt as not comprehended within the purpose of this subsection. Among any other exemptions, the Commission is instructed to exempt any person who has made a bona fide tender offer and who terminates such offer and tenders his securities to a person making a competing tender offer. For purposes of this subsection, the term 'person' shall have the same meaning as provided in section 14(d)(2) whether or not there is express agreement between the parties.".

SEC. 10. ACTIONS BY ISSUERS DURING TENDER OFFERS.

Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is further amended by adding at the end thereof the following new subsections:

"(i)(1) An issuer of equity securities described in subsection (d)(1) which are the subject of a tender offer, or a request or invitation for tenders, shall not from the time the tender offer or request or invitation is commenced until such offer or request or invitation expires or otherwise terminates, undertake any of the following actions:

"(A) enter into or amend any agreement which provides for an increase, directly or indirectly, in the current or future compensation of any officer or director of such issuer, conditioned upon a change in control of the issuer, except that this provision shall not prohibit any routine increase in compensation consistent with past practices or any agreement to effect any such increase, or the grant of reasonable severance pay;

"(B) purchase, directly or indirectly, any of its securities at a price above the market price for such securities from any person who holds more than 2.5 per centum of the class of securities to be purchased and who has held such securities for less than one year; or

"(C) grant, declare or establish any rights to acquire any securities, if such rights would—

"(i) entitle the holder of such rights to purchase at less than market value securities of a successor to such a corporation;

"(ii) entitle the holder of such rights to purchase at less than market value any securities of the issuer; or

"(iii) require the issuer to repurchase its securities from the holder of such rights at greater than market value; where such entitlement or requirement is conditioned upon a change in control of the issuer, or the acquisition of securities by a third party, or may be invoked only during the pendency of a tender offer or other contest for control of the issuer.

"(2) The Commission may by rule, or by order upon application, conditionally or unconditionally exempt any person, security or transaction from the provisions of this subsection to the extent that such exemption is necessary or appropriate in the public interest and for the protection of investors and consistent with the purposes and policy fairly intended by this subsection.".

SEC. 11. FINANCING OF TAKEOVERS.

(a) Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended by adding at the end thereof the following new subsection:

"(i)(1) It shall be unlawful for any person, directly or indirectly, by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, to make a tender offer for, or a request or invitation for tenders of, any equity security of a class described in section 14(d)(1) of this title if both (A) more than 25 per centum of the funds or other consideration for the purchase of the maximum number of securities for which such tender offer or request or invitation for tenders is being made is provided or is expected to be provided, directly or indirectly, out of the proceeds of borrowings or the incurrence of debt or the issuance of bonds, notes, debentures, participation, other debt securities or other obligations to pay money (or money's worth in one or more other forms) and (B) it is reasonably expected by the issuer of the equity securities subject to such tender offer or request or invitation for tender, at the time such tender is announced that any one or more of the assets, cash flows, earnings or credit of such issuer of its then affiliates will be looked to, directly or indirectly, to secure or service any of such borrowings, debt, bonds, notes, debentures, participations, other debt securities or other obligations: *Provided,* That the provisions of this paragraph (1) shall not apply to a tender offer for, or a request or invitation for tenders of (a) equity securities of the tendering person or (b) equity securities of any company of which a majority of the persons who were directors of such company immediately prior to the announcement of such tender offer, or request or invitation for tenders, approved the tendering person's plan of acquisition or (c) equity securities of a class the total value of which is less than $100,000,000 or (d) to borrowings or the incurrence of debt or the issuance of bonds, notes, debentures, participations, other debt securities, or other obligations to pay money (or money's worth in one or more other forms) to provide for the purchase of 'qualifying employee security' purchased or acquired by an 'employer stock ownership plan' both as defined in section 4975(e) of title 26, United States Code.

"(2) It shall be unlawful for any person, directly or indirectly, by use of the mails or by any means or instrumentality or interstate commerce or of any facility of a national securities exchange or otherwise, to make a tender offer for, or a request or invitation for tenders of, any equity security of a class described in section 14(d)(1) of this title, other than equity securities of such tendering person, if the funds or other consideration to be offered, in whole or in part, consists of cash.

"(A) unless such cash is at the time of announcement of the tender offer on deposit in an unrestricted, or an interest bearing demand deposit account of the tendering person at a bank or trust company organized under the laws of the United States, a State or the District of Columbia; or

"(B) the offering person has entered into legally enforceable, unconditional and irrevocable commitments (not subject to execution of further definitive agreements) to provide such cash from such banks and trust companies, which commitments are not contingent in any manner upon the success or failure of such tender offer or request or invitation for tenders, or

"(C) a combination of the foregoing: *Provided,* That the provisions of this paragraph (2) shall not apply to a tender offer for, or a request or invitation for tenders of (a) equity securities of the tendering person or (b) equity securities of any company of which a majority of the persons who are directors of such company immediately prior to such tender offer, or request or invitation for tenders, approved the tendering person's plan of acquisition or (c) equity securities of a class the total value of which is less than $100,000,000.

"(3) The Board of Governors of the Federal Reserve System, in consultation with the Securities and Exchange Commission, shall prescribe rules and regulations to effectuate the purpose of this subsection. The Board of Governors is empowered to grant exceptions to the provisions of this subsection by order. In acting on an application for an exception, the Board of Governors of the Federal Reserve System shall consider the positive economic aspects of the transaction, the fairness of the transaction to shareholders, debtholders and creditors of both the acquired and acquiring corporation, and the economic dislocation, including unemployment risks, likely to be caused by consummation of the transaction. The Board of Governors of the Federal Reserve System will be required to respond affirmatively or negativelly within twenty business days of receiving an application for an exception. Decisions of the Board of Governors of the Federal Reserve System denying such exceptions shall not be reviewable in any court, nor shall they be considered by any court by reason of any extraordinary writ or remedy.

"(4) Penalties:

"(a) Any person that violates or conspires to violate sections (1) or (2) of this paragraph shall be subject to a civil penalty of not less than 5 per centum of the borrowings such person has publicly represented it would need to fund the entire proposed transaction.

"(b) Any person (other than an individual) that agrees to provide funds in violation of this paragraph, whether contingently or otherwise, shall be subject to a civil penalty of not less than 1 per centum of the amount of such funds such person agreed to provide plus any interest payment in excess of 1 per centum per annum paid in respect of such funds.

"(c) Any agreement or contract, including contracts of insurance and agreements for indemnity or contribution, in respect of any civil penalty imposed by this paragraph, and all contracts for indebtedness in violation of this paragraph, shall be void.

"(d) On application by any person, any United States Federal District Court shall issue any and all injunctions necessary to prevent any violation of this paragraph.".

SEC. 12. TRADING HALTS.

(b) Section 12(k) of the Securities Exchange Act of 1934 (U.S.C. 781(k)) is amended—

(1) by inserting "(1)" after "(k)"; and

(2) by adding at the end thereof the following:

"(2)(A) It shall be unlawful for a broker or dealer to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of any security (including any put, call, straddle, option, or privilege or any such security, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase such security, but excluding any exempted security), during any period that the primary market for such security has suspended trading in such security for the purpose of facilitating the orderly dissemination of material information concerning the issuer, the security, or the market for the security.

"(B) Any primary market determination to suspend trading—

"(i) shall be effective for purposes of subparagraph (A) for not more than one business day;

"(ii) shall be subject to review by the Commission, on its own motion, or upon request of any adversely affected issuer, broker, dealer, or self-regulatory organization, pursuant to procedures the Commission shall prescribe by rule or regulation; and

"(iii) may be renewed or extended only with the approval of the Commission pursuant to procedures prescribed by such rule or regulation.

"(C) The Commission, by order, shall approve such suspension of trading unless it finds that—

"(i) the grounds for such suspension do not exist in fact;

"(ii) the primary market has not followed its own rules in suspending trading;

"(iii) such rules of the primary market are being applied in a manner inconsistent with the purposes of this title; or

"(iv) such suspension imposes an unnecessary or inappropriate burden on competition.

"(D) If the Commission makes any such findings, the Commission shall set aside such suspension or modify it as appropriate in furtherance of the protection of investors and the public interest. The Commission decision shall be based solely upon consideration of the record before the primary market and such other information as the Commission may deem appropriate. An appeal pursuant to this subsection shall not stay the suspension.

"(E) The Commission shall, by rule or regulation, define the term 'primary market' for purposes of subparagraph (A) of this paragraph. The Commission may, by rule regulation, or order, exempt a broker or a dealer or class of brokers or dealers from the prohibition contained in subparagraph (A) with respect to a particular transaction or classes of transactions or a particular security or class of securities.".

SEC. 13. FORFEITURE.

Section 32(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78ff(c) is amended by redesignating subsection (c) as subsection (d) and inserting the following new subsection:

"(c)(1) Any person who fails to file a statement or information, or who files a statement which contains an untrue statement of a material fact or omits to state a material fact necessary in order to make the statement not misleading, required to be filed under subsections (d), (f)(2), or (g) of section 13 of this title or any rule or regulation thereunder, shall—

"(A) in cases in which no statement or information was filed, forfeit to the United States a sum of not less than $1,000 per day, as determined by the court in its discretion for such failure to file; and

"(B) in cases in which a materially false or misleading statement was filed, forfeit to the United States a sum equal to the greater of (i) 1 per centum of the aggregate market value of the equity securities beneficially owned by such person and required to be reported thereunder for each and every day such statement remained materially false or misleading, or (ii) the difference between (I) the highest market price of such equity securities during the ten trading days immediately following the filing of a corrected statement or report, and (II) the lowest market price of such equity securities between the date on which such false or misleading filing was made and the date on which such filing was corrected.

"(2) Such forfeiture shall be payable into the Treasury of the United States and shall be recoverable in a civil suit in the name of the United States or in a civil suit brought by the Commission or by the issuer of such equity securities (in which case the reasonable expenses of such suit shall be awarded the issuer out of the proceeds of the forfeiture), in either case upon a showing that such failure to file or such false or misleading filing was not the result of inadvertence on the part of the filing party, but no such suit shall be brought more than two years after the date on which such report initially was required to be filed. The Commission, as it deems consistent with the public interest and the protection of investors, may, by order, conditionally or unconditionally exempt from this subsection any such failure to file.".

SEC. 14. ROLE OF STATES.

The Securities Exchange Act of 1934 is further amended by adding at the end thereof the following new section:

"SEC. 36. (a) The Congress declares that the continued regulation by the several States of matters involving the internal affairs of governance of corporations organized under the respective laws of such States is in the public interest. The internal affairs or governance of corporations shall be subject to regulation by the laws of the State under which each such corporation is organized.

"(b) Nothing contained in sections 13 or 14 of this Act or any rules or regulations thereunder shall be construed to invalidate, impair or supersede any law enacted by any State regulating the internal affairs of governance of any corporation organized under its laws, notwithstanding any effect thereof upon any person's ability to cause a change of control of such corporation by means of a tender offer.

"(c) Notwithstanding subsections (a) or (b) hereof, this section does not authorize any State to enact any law which would preclude compliance with the filing, disclosure or other procedural requirements, or the antifraud requirements of sections 13 or 14 of this Act.

"(d) For purposes of this section, the internal affairs or governance of a corporation shall include, but not be limited to, matters relating to the voting rights of security holders, mergers and other business combinations and the approval thereof, the rights and obligations of controlling or other significant shareholders, and other matters relating to the control, management or government of such corporations or to the relative rights and obligations of, and between and among, security holders, directors, officers and their corporations.".

SEC. 15. LEVERAGED BUYOUTS AND GOING PRIVATE TRANSACTIONS.

(a) Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended by adding at the end thereof the following new subsection:

"(j)(1) It shall be unlawful for one or more officers, directors, or employees of an issuer of any security which is registered pursuant to section 12 of this title, or which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of this title, or any closed-end investment company registered under the Investment Company Act of 1940, to acquire all or substantially all of the shares of a class of that issuer's or company's equity securities unless—

"(A) at least sixty days have elapsed between the day of proposed acquisition is publicly announced and the day the acquisition occurs; and

"(B) the issuer or company has obtained a report by an independent appraiser, as provided in paragraph (2), on the proposed acquisition.

"(2) For the purpose of paragraph (1)(B), an issuer or investment company may apply to a United States district court for the district in which it is located for the appointment of an independent appraiser, and such court shall have jurisdiction to appoint an appraiser to review the terms of the proposed acquisition and to report to the issuer or the company the proposed acquisition. The costs of conducting the review and preparing the report shall be paid by the party proposing to acquire the shares.".

(b) Amend section 13(e)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78n) by adding after the first full sentence in that paragraph the following new sentence: "For purposes of this subsection the term 'manipulative' shall not be limited to acts or practices based solely on misrepresentation or nondisclosure.".

SEC. 16. ERISA.

Section 404 of the Employee Retirement Income Security Act (15 U.S.C. 1104) is amended by redesignating paragraph (2) of subsection (a) as paragraph (3) and adding the following new paragraph:

"(2) In discharging the duty of care required by paragraph (1)(B) of this section in connection with a tender offer or request of invitation for tenders, a fiduciary shall consider the benefits of continued security ownership to participants and their beneficiaries.".

SEC. 17. PENALTIES AND ENFORCEMENT.

Section 32A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78ff) is amended by striking out "$100,000" and inserting in lieu thereof "$500,000" and by striking out "five years" and inserting in lieu thereof "ten years," and by adding at the end thereof "A mandatory one-year term of imprisonment will be imposed on any person convicted of obstructing justice or who commits perjury, in the course of any investigation by the Commission."

SEC. 18. FEDERAL RESERVE BOARD STUDY OF THE FINANCING CORPORATE TAKEOVERS.

(a) The Board of Governors of the Federal Reserve System ("the Board") in consultation with such other agencies as it deems appropriate, shall conduct a comprehensive study of the issuance of and investment of high yield, noninvestment grade bonds used to finance corporate takeovers during the five years prior to the date of enactment of this Act, including but not limited to—

(1) the identity of the issuers and the purchasers that invest in such high yield, noninvestment grade bonds that are issued as a method of financing corporate takeovers;

(2) the distribution system, the liquidity and the secondary market for such high yield, noninvestment grade bonds that are issued as a method of financing corporate takeovers;

(3) the relationships between issuers, investors and underwriters of high yield, noninvestment grade

bonds that are issued as a method of financing corporate takeovers.

(b) The Board in consultation with such other agencies as it deems appropriate, shall conduct a comprehensive study of the role and extent of commercial banks in the financing of corporate takeovers, including but not limited to, the level of risk involved in commercial banks, the average terms and conditions of such financing, and the effect on the commercial bank.

(c) The Board in consultation with the Securities and Exchange Commission and with such other agencies as it deems appropriate, shall conduct a comprehensive study of the role of "bridge loans" and other financing by investment banking firms or their affiliates which are extended in the course of a corporate takeover, including but not limited to the extent to which such financing occurs, the average terms and conditions of such financing and the effect on the acquiring company or person, the risks incurred by lenders who provide the funds to such firms or affiliates, the investment banking firm, or affiliate and the company acquired.

(d) The Board, in consultation with such other agencies as it deems appropriate, shall conduct a comprehensive study of the increase in corporate debt and its relation to equity capital during the five years prior to the date of enactment of this Act, including, but not limited to—

(1) the causes and reasons for this increase in corporate debt;

(2) the short and long-term implications of such an increase in corporate debt; and

(3) the need, if any, of imposing additional or more restrictive requirements regarding the use of debt to finance corporate takeovers.

(e) Each department, agency, and instrumentality of the executive branch of the Government, including independent agencies, shall furnish to the Board, upon its request, such information as the Board deems necessary to carry out its functions.

(f) Upon request of the Board, each department, agency, and instrumentality of the executive branch of the Government, including independent agencies, shall detail staff and personnel as necessary to assist the Board.

(g) The Board shall, within one hundred and eighty days after enactment of this Act, submit to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Energy and Commerce a final report containing a statement of the findings and conclusions of the Board resulting from the study undertaken under this section, including recommendations for such administrative and legislative actions as it deems advisable.

SEC. 19. EFFECTIVE DATE.

The effective date of this legislation is its date of enactment.

Many Senators on and off this committee have worked on corporate takeover legislation and all meritorious suggestions shall be considered during the next 3 days.

Incidentally, the Senate Majority Leader has spoken to me several times about this and about how concerned he is that we act on this as promptly as possible.

The Senate Banking Committee has considered the issue of corporate takeovers for several years now. In the 99th Congress, we held numerous hearings amassing a record spanning 1,274 pages. This year we continued those hearings and we will hold still another factfinding session this Friday, June 26.

In our hearings we have heard about the need to promote an efficient market and protect shareholder rights. We have also heard of the abuses wrought by hostile raids destroying communities and jobs, undermining our corporate competitiveness.

Many of us have serious questions. What good is it to promote an efficient capital market if it only serves to swamp our companies with debt? What good are shareholders' rights if merger mania emasculates competitiveness?

Even as we have examined the problem it proliferates. Raiders enjoyed a highly profitable spring with a host of formerly healthy corporations now devastated by debt incurred during the attacks. Nor can we ignore the ongoing white collar crime wave engulfing Wall Street.

The States are also looking to us. Delaware, where 40 of the Fortune 500 are based, delayed acting on takeover legislation this year, in part because they expect Congress to act. Other committees in Congress are bristling for action, attempting to protect victims of merger mania where their jurisdiction allows.

The American public also expects action, as a recent Harris poll demonstrates. Sixty-seven percent of those polled favor legislation that sharply restricts takeovers. I will call for a committee markup on July 15. We are all too well aware of the problem. It is time to craft solutions.

We are honored to have two distinguished and able witnesses before us this morning. Dr. Sprinkel is an old friend of this committee. He's a man who has very excellent experience in the private sector at the Harris Bank, and he's a widely recognized economist of great ability and, of course, he is Chairman of the Council of Economic Advisers, which makes him the principal economic expert advising the administration.

Mr. Sprinkel, go right ahead, sir.

STATEMENT OF BERYL SPRINKEL, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Mr. SPRINKEL. Thank you, Senator Proxmire. I am delighted to be here today.

I am here to present the administration's views on legislation concerning corporate takeovers, including our position on S. 1323, the Tender Offer Disclosure and Fairness Act of 1987. My testimony reflects the Economic Policy Council's recent consideration of legislation concerning corporate control transactions, as well as the recommendations of the administration's Working Group on Financial Transactions.

I shall begin my discussion by looking at the economic evidence on corporate control transactions. Then I shall discuss the administration's approach to corporate governance issues. Finally, I shall discuss several provisions contained in S. 1323 that the administration finds objectionable. These provisions are very technical and I believe they deserve discussion in some detail during my prepared remarks. Other bills, such as S. 227 and S. 1324, contain similar provisions. In the interest of brevity, and because I have been requested to express the administration's views on general approaches to corporate takeover legislation, my prepared remarks will address only certain specific legislative provisions found in S. 1323. For reasons I shall discuss, the administration opposes S. 1323.

These are very complicated issues, Senator Proxmire. What I am arguing, in essence, is that the evidence clearly indicates that permitting contested takeovers raises stockholder wealth and, in the process, improves resource allocation in the U.S. economy, raises the wealth of the total economy, and benefits U.S. citizens.

Efforts such as those included in your bill would make it more expensive, more difficult to bring this about. It would therefore lead to a poorer allocation of resources, would lead to fewer job creations, and would reduce economic growth.

From the standpoint of the administration, our interest is not in terms of a particular group—it's in the national interest of encouraging economic growth, encouraging the most efficient allocation of resources. We believe that the evidence on this front is very clear. Study after study indicates that stockholder wealth is improved through this mechanism of takeovers.

Now we are not concerned especially about investors per se. They should not be favored vis-a-vis workers, or vis-a-vis management. We are concerned about the wealth of the total economy, and we believe that the provisions which slow up this process will clearly reduce standards of living of American citizens and, therefore, we oppose the bill. That's the shortest I can say.

[The complete prepared statement of Berly W. Sprinkel follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON D.C. 20500

TESTIMONY OF BERYL W. SPRINKEL,
CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS,
BEFORE THE SENATE BANKING COMMITTEE
CONCERNING CORPORATE TAKEOVERS

June 23, 1987

I am here today to present the Administration's views on legislation concerning corporate takeovers, including our position on S. 1323, the "Tender Offer Disclosure and Fairness Act of 1987." My testimony reflects the Economic Policy Council's recent consideration of legislation concerning corporate control transactions, as well as the recommendations of the Administration's Working Group on Financial Transactions.

I shall begin by discussing the economic evidence on corporate control transactions. Then I shall discuss the Administration's approach to corporate governance issues. Finally, I shall discuss several provisions contained in S. 1323 that the Administration finds objectionable. These provisions are very technical, and I believe they deserve discussion in some detail during my prepared remarks. Other bills, such as S. 227 and S. 1324, contain similar provisions. In the interest of brevity, and because I have been requested to express the Administration's views on general approaches to corporate takeover legislation, my prepared remarks will address only certain specific legislative provisions found in S. 1323. For reasons I shall discuss, the Administration opposes S. 1323.

I. The Evidence on Corporate Control Transactions

The lexicon of corporate governance is notorious for its hyperbole. Even the most basic terms like "takeover" and "raider" convey pejorative, militarist images. There is, therefore, a danger that semantics will displace substance. However, a substantial body of scientific research exists on the effects of corporate control transactions and corporate governance issues. Therefore, the Administration believes that the policy debate should center on this empirical evidence rather than on unsupported rhetoric and irrelevant arguments.

A. *Distinguishing Insider Trading Issues From Corporate Governance Issues*

There is a danger that concern over Wall Street's recent insider trading scandals will overshadow the real issues posed by Federal legislation that would alter corporate governance. The Administration believes that the recent prosecutions show the vigilance of the Securities and Exchange Commission in combating

insider trading. But insider trading and corporate governance are two separable issues, and the Administration believes that concern over insider trading should not detract from the dispassionate analysis of the technical proposals to alter corporate governance contained in S. 1323 and similar bills.

To the degree that insider trading is associated with tender offers, it is only because tender offers are like other pieces of information that indicate the potential for dramatic profits, such as the unexpected mineral discovery in the *Texas Gulf Sulphur* case. Any such dramatic event will present a temptation to insiders possessing the information before its public disclosure. There is nothing unique about corporate control transactions in this regard.

Furthermore, it is critical to recognize that bidders in tender offers do not necessarily gain from insider trading. To the contrary, insider trading often *harms* a bidder making a tender offer and gives him a strong incentive to prevent it. A change in corporate control occurs when an alternative management team believes it can manage a corporation's resources more productively than can the incumbent management. For this reason, the rival management team is willing to offer a premium for the corporation's shares over the present market price. Until the bidder announces his intentions, the prospect of an imminent change in corporate control is information known to the rival management team and its professional advisers, but information not known publicly. Such information is analogous to the information, prior to public disclosure, that a mining company would have upon discovering a valuable new mineral deposit. Insider purchases made before the announcement of a tender offer hurt bidders because they drive up the price of the target's stock. Such purchases reduce the return to investing in the production of information about good takeover targets.

Nothing about this variety of insider trading is unique to the corporate takeover process. To argue that tender offers should be restricted in order to prevent insider trading would be analogous to arguing that mineral exploration should be restricted in order to prevent insider trading before the disclosure of a valuable mineral discovery. Corporate control transactions produce information that is valuable to someone predisposed to committing insider trading. But the content of that information is that new management can be expected to run a corporation more productively and cause shareholder wealth to increase. The creation of value from a corporate control transaction does not compel anyone to commit insider trading. The possibility that such insider trading may occur should not denigrate the social value of the market for corporate control.

B. *The Relevant Policy Issue: Corporate Governance, Not Mergers and Acquisitions*

At the outset, it is important to recognize that the relevant policy debate over corporate takeovers is narrow in focus. The issue is not mergers in general, nor is it tender offers in general. The issue is strictly confined to *unsolicited changes in corporate control*. As Table 1 indicates, contested tender offers in 1986 accounted for *only 1.2 percent* of all mergers and acquisitions. So, it is simply false to suggest that contested tender offers are reducing competition throughout the economy.

Even if aggregate statistics on mergers were relevant to the public policy debate on corporate governance, the data in Table 2 show that recent merger and acquisition activity, as measured by the number of reported transactions, has been considerably lower than that reported in the late 1960s and early 1970s. The announced value of merger and acquisition transactions reported in the first three months of 1987 was $39 billion. On an annualized basis measured in constant 1982 dollars, this activity represents $134 billion in mergers and acquisitions, a decrease of about 17 percent since 1985 and only 16 percent above the previous peak recorded in 1968. Moreover, as a percentage of real GNP, the value of mergers and acquisitions during the last several years has never reached the level in 1968 of 4.9 percent. This percentage declined between 1985 and 1986, and it appears to be considerably lower -- 3.6 percent -- on an annualized basis for the first three months of 1987.

These various aggregate statistics support the conclusion that the relative intensity of merger activity during the 1980s has not been greater than at other periods of merger activity during the 20th Century. Nonetheless, critics of corporate takeovers often warn that these transactions increase monopoly power. This possibility seems unlikely.

Anticompetitive mergers, of course, can occur amicably as well as through contested tender offers. A tender offer is merely a transactional vehicle for acquiring management control over the assets of a publicly-traded corporation. It is a substitute for the negotiated sale of the corporation's assets, or a change in control effected through a proxy contest. If a business combination enables firms to raise prices and reduce output, it does so because it changes the competitive conditions of the particular market, not because the parties use a tender offer to effectuate the business combination rather than some other transactional device.

Moreover, there is reason to believe that mergers and acquisitions resulting from contested tender offers are less likely than friendly mergers and acquisitions to raise antitrust concerns. In general, mergers and acquisitions are a public policy concern only if they occur between horizontal competitors

Table 1 -- Number of tender offers as a percent of total mergers and acquisitions, 1974-1986

Year	Total mergers and acquisitions	Tender offer attempts		Contested tender offers	
		Number	Percent of all mergers and acquisitions	Number	Percent of all mergers and acquisitions
1974	2,861	76	2.7	12	0.4
1975	2,297	58	2.5	20	0.9
1976	2,276	70	3.1	18	0.8
1977	2,224	69	3.1	10	0.4
1978	2,106	90	4.3	27	1.3
1979	2,128	106	5.0	26	1.2
1980	1,889	53	2.8	12	0.6
1981	2,395	75	3.1	28	1.2
1982	2,346	68	2.9	29	1.2
1983	2,533	37	1.5	11	0.4
1984	2,543	79	3.1	18	0.7
1985	3,001	84	2.8	32	1.1
1986	3,336	150	4.5	40	1.2
1981-85	16,154	493	3.1	158	1.0

Source: W.T. Grimm & Co., MERGERSTAT REVIEW, 1986.

Table 2. Number and value of merger and acquisitions, 1963-1987
(billions of dollars)

Year	FTC estimates of acquisitions of large firms in mining and manufacturing 1			W.T. Grimm & Co. estimates of merger and acquisition activity			
	Number of transactions	Value of assets exchanged		Number of transactions 2	Value of consideration exchanged 3		Value of M&A relative to real GNP (percent)
		Nominal dollars	Constant (1982) dollars		Nominal dollars	Constant (1982) dollars	
1963	54	2.5	7.7	1,361	na	na	na
1964	73	2.3	7.0	1,950	na	na	na
1965	64	3.3	9.8	2,125	na	na	na
1966	76	3.3	9.4	2,377	na	na	na
1967	138	8.3	23.1	2,975	na	na	na
1968	174	12.6	33.4	4,462	43.0	115.6	4.9
1969	138	11.0	27.6	6,107	23.7	59.5	2.5
1970	91	5.9	14.0	5,152	16.4	39.1	1.6
1971	59	2.5	5.6	4,608	12.6	28.4	1.1
1972	60	1.9	4.1	4,801	16.7	35.0	1.4
1973	64	3.1	6.1	4,040	16.7	33.7	1.2
1974	62	4.5	8.3	2,861	12.5	23.1	0.8
1975	59	5.0	8.4	2,297	11.8	19.8	0.7
1976	82	6.3	10.0	2,276	20.0	31.7	1.1
1977	101	9.2	13.7	2,224	21.9	32.5	1.1
1978	111	10.7	14.8	2,106	34.2	47.4	1.5
1979	97	12.9	16.4	2,128	43.5	55.3	1.7
1980	na	na	na	1,889	44.3	51.7	1.6
1981	na	na	na	2,395	82.6	87.0	2.7
1982	na	na	na	2,346	53.8	53.8	1.7
1983	na	na	na	2,533	73.1	70.4	2.2
1984	na	na	na	2,543	122.2	115.5	3.2
1985	na	na	na	3,001	179.8	161.3	4.5
1986	na	na	na	3,336	173.1	151.2	4.1
1987							
3 months	na	na	na	143	39.0	33.3	na
Annualized	na	na	na	2,572	156.0	134.0	3.6

1 "Large" firms are defined as those with assets of $10 million or more. Excluded from the tabulation are firms for which asset data are not publicly available.
2 The W.T. Grimm & Co. tabulations measure only publicly announced transactions and include transfers of ownership of 10 percent or more of a company's assets or equity, provided that the value of the transaction is at least $500,000.
3 Includes only those transactions for which valuation data are publicly reported.

NOTE.- Annualized real GNP for 1987 is the average of Wharton, DRI, and Administration econometric forecasts.

Source: Federal Trade Commission (Bureau of Economics) and W.T. Grimm & Co.

and will increase market power.[1] Market power refers to the ability of a single firm (or group of firms acting jointly) to restrict output and thereby increase price above the competitive level without losing so many sales as to make the price increase unprofitable.[2]

Clearly, if a particular horizontal merger or acquisition would create market power, it would benefit the two parties to the transaction. Therefore, it would be in the self-interest of both firms to enter into a transaction amicably. A contested, unsolicited proposal to merge one firm into the other would be unnecessary. This is not to say that contested tender offers are not made between competitors. However, if it takes a contested tender offer to consummate a merger or acquisition, it seems less likely that the merger or acquisition between competitors will create market power for the combined entity than if the transaction were a friendly one.[3] Therefore, antitrust concerns should not distract the focus of the policy debate on corporate control transactions.

C. *Benefits to Shareholders and to the Economy as a Whole from Corporate Control Transactions*

Put simply, the relevant policy question is: Do unsolicited corporate control transactions improve the process of corporate governance, thereby benefiting shareholders and increasing the productivity of the corporation? If, on balance, they promote the efficient allocation of resources, the transactions are beneficial and should not be impeded by Federal or state policy. In contrast, if the costs of these transactions exceed their benefits, then regulation of the takeover process may be appropriate.

The available evidence, however, is that unsolicited transactions that effect mergers and acquisitions increase national wealth.[4] They improve efficiency, transfer scarce resources to higher valued uses, and stimulate effective corporate management. They also help recapitalize firms so that their financial structures are more in line with prevailing market conditions. In addition, there is no evidence that mergers and acquisitions (including friendly ones) have, on any systematic basis, caused anticompetitive price increases.

These findings are consistent with the possibility that some individual transactions turn out to be misguided and generate losses for acquirers. The risk of economic loss attends any investment, not just a corporate acquisition, and can occur whether the original transaction or investment was misguided or astute. Unforeseen events may diminish the value of otherwise astute acquisitions or investments. Consequently, public policy toward takeovers should not be based on the outcomes of individual transactions, for it is impossible to predict in advance which transactions will succeed and which will fail.

Public policy, therefore, must be based on aggregate trends describing the consequences of contested corporate control transactions as a whole.

Recent calls for regulation of bidder tactics in takeover contests are based on claims that some tactics are coercive, and that they fail to allow stockholders adequate time to inform themselves about the bidder's offer. Critics also claim that target managements do not have adequate time to mount defenses against proposed takeovers. In addition, some critics question whether takeovers benefit the economy. These critics suggest that takeovers should be subject to regulations that necessarily would make them more expensive and difficult to complete.

There is, however, little credible economic evidence that tactics used by bidders in takeover contests should be subject to further regulation. The available evidence shows that any regulatory change that would increase the cost of mounting takeovers is likely to cause losses for the economy by deterring takeovers.[5] Viewed from this perspective, proposals to increase regulation of bidder practices do not benefit shareholders.

The evidence is overwhelming that successful takeovers substantially increase the wealth of stockholders in target companies.[6] Maximizing shareholder wealth through the enhancement of a competitive market for the management of public corporations serves the national interest and should be the guiding principle in issues of corporate governance. This is not because the millions of American investors who each own a small part of the nation's corporations deserve special treatment relative to consumers or workers or any other constituency. Instead, it is because, in the process of maximizing the wealth of America's shareholders, we create benefits for the economy as a whole.

The success of the American economy depends on competition. Competition stimulates managers to respond to rapidly evolving technologies. Competition requires that firms adapt to changing market demands and calls upon them to adjust to fluctuating capital market conditions. Competition breaks down entrenched market positions, helps discipline managers, and provides incentives for innovative forms of business organization and finance. In sum, competition plays a central role in the evolution of the economy: It promotes efficient modes of production and eliminates processes and organizational structures that have outlived their usefulness.

Publicly-traded corporations account for a substantial portion of the Nation's wealth and productive capacity. It is critical that the management of these firms not be insulated from competition in the market for corporate control. The available evidence is that the operation of this market has generated net benefits for the economy. Thus, in the process of maximizing returns to shareholders, managers who are subject to competition in the market for corporate control must continually explore new ways to make America's corporations more productive and more competitive in the world economy -- and this result clearly benefits American consumers and workers as well as the shareholders themselves.

Although estimates of the magnitude of the wealth increase for shareholders vary, recent studies find average gains in the range of 16 to 34 percent of the value of the target's shares.[7] The data regarding changes in the value of acquiring companies are not as uniform. However, in my opinion the best available evidence shows that the value of acquiring companies' shares also increases as the result of takeovers, but that the amount of the increase has decreased over time.[8]

That scientific evidence is consistent with the operation of an efficient capital market. On average, and over the long run, bidders will not desire or be able to complete acquisitions unless the acquisitions are expected to be profitable for the bidding firm. Indeed, bidders often terminate or reduce the price of their offers when scrutiny of the target leads them to conclude that the initial offer price was too high. Target stockholders will similarly refuse to sell their shares until their wealth increases as a result of the transaction. The available evidence suggests that corporate control transactions are, on average, beneficial for stockholders in both bidder and target firms.

II. The Administration's Position on Corporate Governance

The Administration favors efforts to enhance the ability of shareholders to monitor the performance of management and to direct the control of their corporation. The Administration opposes initiatives by the Federal Government that would impede the market for corporate control or dictate to shareholders how to structure the governance of their corporation. Sometimes shareholder self-determination takes the direct form of shareholder votes; other times it is undertaken collectively through corporate governance legislation at the State level. In the Administration's view, either of these avenues is preferable to intrusive Federal regulation of corporate governance.

The Administration believes, as the Supreme Court recently emphasized in *Dynamics Corporation of America v. CTS Corporation*,[9] that the Federal Government has a limited role in regulating issues of corporate governance. Although corporate governance clearly is an issue of great national importance, it does not follow that it is necessary or desirable for the Federal Government to define how corporations chartered in the various States ought to be governed by their shareholders.

There is a powerful economic argument for not regulating

The CHAIRMAN. Very good. Well, I appreciate that very much and I think your last 2 minutes, while I disagree with almost every word of it, were extremely well put and I think that you show that you can summarize very quickly and very effectively.

Now, Mr. Cox, you have 10 minutes. The light will start when you begin.

STATEMENT OF CHARLES COX, COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION

Mr. Cox. Thank you. Chairman Proxmire and members of the committee. The Securities and Exchange Commission appreciates this opportunity to present its views on legislation before the committee relating to corporate takeovers. In particular, I will comment on a number of issues presented by S. 1323, the Tender Offer Disclosure and Fairness Act of 1987, S. 1324, the Corporate Takeover and Insider Abuse Reform Act of 1987, and S. 227, the Tender Offer Reform Act of 1987.

I request that the Commission's written testimony delivered to the committee earlier be included in the record.

The CHAIRMAN. Without objection, so ordered.

Mr. Cox. The Williams Act was intended to provide investors with information about substantial share acquisitions that might result in a change in corporate control. It was also intended to provide investors confronted with a tender offer with adequate information and with certain substantive protections assuring an opportunity to make informed investment decisions. The Commission believes that the act's basic approach remains sound: Achieving investor protection through means that assure the generally free transferability of securities and that are neutral as among tender offerors and the target company.

The Commission supports several proposals contained in the bills that, whether implemented through legislation or administrative action, would further the objectives of the Williams Act. Most notably, the Commission supports improvements to the regulatory scheme requiring prompt disclosure after substantial securities positions have been accumulated. We believe this objective could be achieved by prohibiting further securities purchases pending filing of form 13D, within a reduced minimum period.

Nevertheless, the Commission is concerned that the cumulative effect of the many other wideranging amendments contained in the bills would be a radical departure from the historical purposes of Federal securities regulation, fundamentally altering not only the market for corporate control, but also the structure and operation of the Nation's securities markets as a whole. The Commission opposes this approach. For example, restrictions of open market purchases and partial ownership of corporations, particularly when coupled with stringent sanctions and express private rights of action, would impair the depth of liquidity of the markets and the formation of capital. They would hinder transactions never before considered abusive and completely unrelated to the contests for control that are the committee's concern. So-called "market sweeps" and similar circumventions of present tender offer procedures can, we believe, be addressed administratively.

Although two of the bills call for preserving State and Federal restrictions on certain defensive tactics such as "greenmail," "golden parachutes," and "poison pills." The regulation of intracorporate duties has traditionally been the sphere of State law, and the Commission does not believe current experience justifies a repudiation of that principle. The Commission does, however, believe that additional disclosure may be an appropriate response to greenmail, and one more consistent with the disclosure orientation of Federal securities regulation.

We also believe that a number of the additional reporting and registration requirements proposed would be disproportionate in cost and burden to their likely remedial effect and their usefulness to investors.

Finally we do not believe that a need has been shown for reducing such levels as the 5-percent threshold for reporting substantial share acquisition or increasing the minimum tender offer period. The later subject in particular already has been the subject of lengthy and deliberate Commission consideration.

Although the Commission regards the pending bills as containing a number of constructive suggestions, we believe that on balance the packages presented would do more to retard then to advance free and efficient capital markets and overall investor welfare.

[The complete prepared statement of Charles C. Cox follows:]

issues of corporate governance at the Federal level. Traditionally, the balance between management's need to act expeditiously in the interest of the corporation and the shareholders' right to call that action into account has been resolved at the level closest to the issue and the relevant facts -- by the shareholders of the corporation in the first instance, and then by State law, if necessary. Two desirable results arise from placing corporate governance decisions as close to the shareholders as possible. First, the decisionmakers closest to the issue are likely to have the best information with which to make decisions. Second, the opportunity arises for experimentation with different rules of corporate governance.

Empirical evidence shows that the varying approaches that different States use to address issues of corporate governance produce competition between the States.[10] Far from causing a "race to the bottom," this competition encourages corporate resources to flow into the State whose rules for corporate governance maximize shareholder welfare. For these reasons, the Administration believes that the Federal Government should not deny shareholders and the States the freedom to choose the corporate governance rules that best protect the investments that shareholders have made in a corporation.

III. Comments on Specific Provisions of S. 1323

The Administration believes that the net effect of S. 1323 would be to impede the market for corporate control and to intrude into areas of corporate governance that should be left primarily to the shareholders and, secondarily, to the States. For these reasons, the Administration opposes S. 1323.

We comment below on several provisions of S. 1323 that particularly concern the Administration. By commenting on these specific sections of the bill, the Administration does not imply that it endorses sections of S. 1323, or sections of other bills, not discussed here.

A. *Revisions to Section 13(d) of the 1934 Act*

The Administration believes that provisions in S. 1323 to amend section 13(d) of the Securities Exchange Act of 1934 are biased in favor of protecting incumbent management against a change in corporate control unsolicited by management. These provisions would severely deter tender offers, to the detriment of nonmanagement shareholders. The Administration opposes these provisions.

1. *Disclosure Threshold, Filing Period, and Purchase Halt*

Sections 3(a) and 3(f) of the bill would (1) lower the disclosure threshold from 5 percent to 3 percent; (2) reduce the 10-day filing period to one trading day; and (3) prohibit the

acquirer, after reaching the 3-percent disclosure trigger, from acquiring further shares until he has filed a Schedule 13D with the SEC. These provisions would have the effect of requiring any investor who intended to make a subsequent tender offer to share the fruits derivable from his takeover strategy with the entire public.

The investor's decision to make a tender offer relies on the production of valuable information -- namely, that the target corporation would be worth more in the hands of other managers. By forcing the investor to share a greater portion of the value flowing from the creation of such information, section 3 would diminish the incentive for investors to produce this kind of valuable information in the future. Consequently, beneficial changes in corporate control would be less likely to occur.

2. *Disclosure of Acquisition Groups Acting in "Conscious Parallelism"*

Section 5 of S. 1323 would expand the definition of a group required to file a Schedule 13D by defining the term "person" to include persons acting in a "consciously parallel manner," even if such persons were not organized as a group. Pursuant to section 3(b) of the bill, the Schedule 13D would have to disclose the identities of any persons with whom the filer "has had communications" within the last 90 days who either (1) have themselves filed a Schedule 13D covering securities of any issuer, or (2) have "acquired or agreed to acquire any equity securities of the same class." Section 3(e) of S. 1323 would further require that the Schedule 13D contain an itemized statement of all expenses and fees incurred or estimated to be incurred in connection with the acquisition.

These expanded disclosure requirements would provide new causes of action for defensive litigation by incumbent management. Because such litigation would be likely to raise material issues of fact relating to causation and intent, it would be a costly obstacle to a person making a tender offer. The inherent vagueness of the "conscious parallelism" standard would particularly suit the dilatory objectives of management resisting a tender offer. There is no indication what social benefits (if any) would flow from these expanded disclosure requirements, particularly the disclosure of the acquirer's expenses and fees. It seems improbable that any social benefits from such additional disclosure would exceed the forgone share premiums to shareholders because of the reduced number of successful tender offers.

3. *Prohibition Against a 3-Percent Investor Making a Tender Offer for 6 Months*

Section 5 of S. 1323 would require that, if an investor disclosed in his Schedule 13D that he had acquired a 3-percent stake in a corporation for investment only, he could not make a tender offer for the same class of securities for six months after filing an amended Schedule 13D. A 3-percent shareholder is one of the few shareholders whose holdings are large enough to justify spending a substantial amount of personal resources to monitor the performance of management. These monitoring efforts benefit all shareholders. But section 5 of the bill would insulate incumbent management for 6 months from the most efficient means that the 3-percent shareholder could use to increase the value of the corporation -- namely, an unsolicited tender offer. Therefore, this section of S. 1323 would undermine the discipline imposed on incumbent management by the market for corporate control.

B. *Tender Offer Procedures*

Section 7 of S. 1323 would substantially alter existing tender offer procedures, making it far more difficult for successful tender offers to be conducted. This result would severely harm the Nation's shareholders. Therefore, the Administration opposes these provisions.

1. *Lengthening of Minimum Offering Period*

The Administration believes that the present 20-business-day minimum offering period provided under the Williams Act affords shareholders and incumbent management sufficient time to evaluate a tender offer and any higher alternative bids. Consequently, the Administration strongly opposes the provision in section 7(b) of S. 1323, which would nearly double the minimum duration of a tender offer by extending it to 35 business days.

The present minimum offering period provides approximately a calendar month within which incumbent management can evaluate an offer and, if it chooses, solicit other bidders. A study of 162 contested takeovers between 1962 and 1980 involving firms listed on the New York and American Stock Exchanges found that approximately 28 percent of these contests involved multiple bidders.[11] The current minimum offering period thus appears to provide ample time for many targets to find alternate bidders.

In addition, longer minimum offering periods probably would generate more of the same costs that accompanied adoption of the Williams Act: They would increase the cost of takeovers (such as the costs of financing a tender offer); reduce the total number of takeovers; reduce the benefits generated by the takeover process; increase the premiums paid to stockholders of the fewer companies who receive offers; and distract management's primary concern for a longer period of time from the business of running the corporation. Such an outcome is not in the national interest because it reduces the aggregate gain from the takeover process and increases the resources spent on nonproductive bargaining over the allocation of these gains.

2. *Prohibition on Stock Acquisitions After 15 Percent, Unless by a Tender Offer*

Section 7(b) would prohibit any stock purchase that would put the acquirer's stake at more than 15 percent, unless the purchase was made pursuant to a tender offer. Even if the purchaser wanted to increase his passive investment from, say, 15 percent to 16 percent, he could not do so without resorting to a tender offer.

This provision would substantially raise the cost to develop and transfer significant minority shareholdings in any publicly-traded corporation. This result would be highly undesirable, for significant minority shareholders who are not actively mounting takeovers nonetheless can demand management accountability that redounds to the benefit of all shareholders, large and small. In addition, this cost barrier to acquiring more than 15 percent of a publicly-traded corporation would prevent the formation of many beneficial joint ventures and risk-sharing arrangements.

C. *Golden Parachutes Prohibited*

Federal regulation of takeover-related severance contracts would be unlikely to create any clear benefits for stockholders or for the economy at large. Such regulations would require costly and difficult enforcement procedures and would constitute an unprecedented and unwise intrusion into an area traditionally reserved to private contracts and State law. Therefore, the Administration opposes the prohibition against golden parachutes contained in section 8 of S. 1323.

The available evidence on the effects of these severance contracts is inconclusive. A study of 90 companies that have adopted such contracts shows a small, statistically insignificant positive effect on stock prices.[12] Moreover, the Tax Reform Act of 1984 imposes substantial tax burdens on certain severance contracts. It is too soon to be able to assess the impact of this legislation on takeover-related severance agreements.

Although S. 1323 would prohibit severance contracts adopted while a takeover bid is pending, firms could readily avoid that prohibition by entering into the contracts prior to announcement of a tender offer. A May 1986 survey of 424 of the *Fortune* top 500 companies showed that 198 already had severance agreements with senior management that are triggered by a change in control, and that another 53 had employment agreements with officers, many of which contain "dismissed without cause" clauses.[13] Indeed, the labor market for senior executives may in some situations require that senior managers be offered takeover-related severance agreements, just as professional athletes negotiate contracts with beneficial severance provisions. In particular, lucrative severance provisions may be necessary to attract desirable senior executives to corporations that are prone to takeovers because of prior mismanagement. In this respect, prohibiting golden parachutes might actually frustrate shareholders seeking to attract the most effective management.

D. *The Role of State Law*

The Administration strongly opposes section 12 of S. 1323. The Administration respects the primacy of State law in matters of corporate governance. Although section 12 purports to do the same, its actual effect would be to preempt any State law regarding corporate governance that favored the interests of shareholders more than would the pro-management sections of S. 1323. In other words, section 12 would respect State law only when the State added more obstacles to tender offers. If a State believed that fewer impediments to corporate control transactions would best serve the interests of shareholders of corporations chartered in that State, section 12 would preempt State law under the supremacy clause of the Constitution. Thus, section 12 would ensure the federalization of the law of corporate governance. It would destroy the ability of the States to experiment and to compete with one another in the design of laws that maximize shareholder wealth.

IV. Conclusion

The best available evidence indicates that corporate control transactions benefit the economy, and that further Federal regulation in this area runs a high likelihood of causing more harm than good. The Administration believes that S. 1323 would reduce competition in the market for corporate control and usurp the traditional authority of the States to regulate corporate governance. We therefore oppose the bill and reject its general approach to matters of corporate governance.

FOOTNOTES

1. *See generally* United States Department of Justice Merger Guidelines, 47 Fed. Reg. 28,493 (1982).
2. Landes & Posner, *Market Power in Antitrust Cases*, 94 Harv. L. Rev. 937 (1981).
3. *See* Easterbrook & Fischel, *Antitrust Suits by Tender Offer Targets*, 80 Mich. L. Rev. 1155 (1982); Sidak, *Antitrust Preliminary Injunctions in Hostile Tender Offers*, 30 Kan. L. Rev. 491 (1981).
4. *See generally* Jarrell, Brickley & Netter, *The Market for Corporate Control: The Empirical Evidence Since 1980*, 1 J. Econ. Perspectives --- (forthcoming 1987); Jensen, *The Takeover Controversy: Analysis and Evidence*, 4 Midland Corp. Fin. J. 6 (1986) (forthcoming in Takeovers and Contests for Corporate Control (J. Coffee, L. Lowenstein & S. Rose-Ackerman, eds. 1987)); Jensen & Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. Fin. Econ. 5 (1983). *See also* R. Gilson, The Law and Finance of Corporate Acquisitions 430-45 (1986).
5. *E.g.*, Guerin-Calvert, McGuckin & Warren-Boulton, *State and Federal Regulation in the Market for Corporate Control* (United States Department of Justice, Economic Analysis Group Discussion Paper 86-4, 1986); Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J. Law & Econ. 371 (1980).
6. *See, e.g.*, Jensen & Ruback, *supra* note 4.
7. *Id.*
8. *Id.*; Jarrell & Poulsen, *Bidder Returns* (Working paper, 1987).
9. 107 U.S. 1637 (1987).
10. *See* Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J. Law, Econ. & Org. 225 (1985); Dodd & Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" Versus Federal Regulation*, 53 J. Bus. 259 (1980). *See also* Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 Nw. U.L. Rev. 913 (1982).
11. Bradley, Desai & Kim, *Specialized Resources and Competition in the Market for Corporate Control* (University of Michigan, Sept. 1982).
12. Lambert & Larker, *Golden Parachutes, Executive Decision Making, and Shareholder Wealth*, 7 J. Accounting & Econ. 179 (1985). *See also* Knoeber, *Golden Parachutes, Shark Repellants, and Hostile Tender Offers*, 76 Amer. Econ. Rev. 155 (1986).
13. V. Rosenbaum, Takeover Defenses: Profiles of the Fortune 500, at 2, 225-27 (1987).

STATEMENT OF CHARLES C. COX
ACTING CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION
BEFORE THE SENATE COMMITTEE ON BANKING,
HOUSING AND URBAN AFFAIRS

CONCERNING CORPORATE TAKEOVER LEGISLATION

June 23, 1987

Chairman Proxmire and Members of the Committee:

The Commission appreciates this opportunity to present its views on legislation before the Committee relating to corporate takeovers. 1/ In particular, we have been requested to address issues presented by S. 1323, the "Tender Offer Disclosure and Fairness Act of 1987," introduced by Chairman Proxmire along with Senators Riegle, Cranston, Sarbanes, Dodd, Dixon, Sasser, Sanford, and Wirth; S. 1324, the "Corporate Takeover and Insider Abuse Reform Act of 1987," introduced by Senator Sanford; and S. 227, the "Tender Offer Reform Act of 1987," introduced by Senator D'Amato. This statement sets forth the Commission's views on the various approaches to statutory reform reflected in these bills and the Commission's recommendations with respect to legislation. 2/ The Commission would be pleased to provide specific technical comments on the bills, if the Committee so desires.

INTRODUCTION

The Williams Act amendments to the Securities Exchange Act of 1934 comprise the principal federal regulatory scheme governing tender offers and other substantial acquisitions of publicly traded equity securities. 3/ The Williams Act was intended to provide investors with information about substantial acquisitions of an issuer's securities that might result in a change in corporate control. It was also intended to provide to investors confronted

with a tender offer certain substantive protections as well as adequate information and opportunity to make informed investment decisions. The Williams Act's two-pronged regulatory scheme deliberately imposed only post-acquisition disclosure requirements on open market and privately negotiated transactions and did not subject these transactions to the regulatory requirements made applicable to tender offers. The Williams Act reflected a determination to provide necessary investor protections with minimal interference with legitimate business transactions, through means that assure the generally free transferability of securities and that are neutral as among tender offerors and the target company. The Commission believes that the principles underlying the Williams Act's regulatory scheme remain sound and has generally found the statute to be sufficiently flexible to deal with novel and innovative practices.

The Commission supports several proposals contained in S. 1323, S. 1324 and S. 227 that, whether implemented through legislation or administrative action, would further the objectives of the Williams Act. Most notably, the Commission supports improvements to the regulatory scheme requiring prompt disclosure of beneficial ownership of securities.

Nevertheless, the overall approach of the three bills would effect a radical departure from the historical role of federal securities regulation. The cumulative effect of the wide ranging amendments contained in the bills would be to alter fundamentally not only the market for corporate control, but also the structure and operation of the nation's securities markets as a whole. The Commission opposes this approach. The enactment of restrictions on open market purchases and partial ownership of corporations, particularly when they are coupled with stringent sanctions and express private rights of action, would impair the depth and liquidity of the markets and the formation of capital.

I. SECTION 13(d) - DISCLOSURE OF BENEFICIAL OWNERSHIP

S. 1323, S. 1324, and S. 227 each contain provisions that would amend Section 13(d) of the Exchange Act to improve the disclosure to the public and marketplace of acquisitions of the shares of publicly-held companies. The Commission agrees that accumulations of securities that may have the potential to influence control of publicly-held companies should be disclosed in a timely and effective manner. Accordingly, the Commission could support amendments to shorten the initial filing period, to impose a standstill against further acquisitions until the requisite filing is made, and to impose further sanctions. Any additional disclosure requirements should be effected through the rulemaking process. Through rulemaking, the Commission can respond flexibly to the continually changing takeover environment.

1/ The views expressed in this statement are those of the Securities and Exchange Commission and do not necessarily represent the views of the Administration.

2/ This statement addresses policy and practical issues raised by the principal provisions of the three bills. It does not address the specific issue of the proposed increased criminal penalties for violations of the securities laws or the proposed amendments to ERISA. It does not generally discuss technical drafting questions.

3/ The Williams Act, enacted in 1968 and amended in 1970, added Sections 13(d), 13(e), 14(d), 14(e), 14(f) to the Securities Exchange Act. Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 454; Act of Dec. 22, 1970, Pub. L. No. 91-567, 84 Stat. 1497 (codified at 15 U.S.C. 78m(d)-(e) and 78n(d)-(f) (1970)).

A. Filing Period and Standstills

The proposals under consideration would reduce the filing period for initial beneficial ownership statements. Under Section 13(d)(1) of the Exchange Act, persons who acquire beneficial ownership of more than five percent of a class of covered equity securities are required to notify the issuer, each exchange on which the security is traded, and the Commission of certain information. 4/ The present provision gives the acquiring shareholder 10 days after crossing the five percent threshold within which to submit the required information, allowing the purchaser to acquire additional shares within that period prior to making any disclosure. In some situations, the 10-day filing period has enabled persons to acquire substantial positions prior to disclosure by continuing to acquire during the 10-day window.

S. 1323 would reduce the current 10-day period within which to file the initial acquisition statement to "not later than the close of business on the next trading day after such acquisition." Purchasers crossing the threshold would be prohibited from purchasing or agreeing to purchase additional shares prior to the filing of the report and the dissemination of a public announcement. S. 1324 would similarly impose a next business day filing requirement and impose a two-day standstill requirement. S. 227 would require filing and a public announcement within 24 hours, and impose a two-day standstill requirement.

The Commission supports closing the "10-day window," but suggests that the window be closed in a manner different from that proposed in pending legislation. In 1983, the Commission's Advisory Committee on Tender Offers found that the 10-day window presented "a substantial opportunity for abuse," and recommended that the filing window be shortened to "provide adequate notice of the shareholder's investment and intentions regarding the issuer and [to allow] time for the market to assimilate such information." In May 1984, the Commission proposed legislation based on the recommendations of the Advisory Committee. On March 12, 1986, the Commission again submitted to Congress a legislative proposal to amend Section 13(d) to reduce from 10 to 2 days the time within which Schedule 13D filings must be made.

4/ This information includes (1) the title and class of the security and the name and address of the issuer; (2) the identity and certain background information on the purchaser; (3) the source and amount of funds or other consideration used in making the purchase; (4) the purpose of the acquisition; (5) the aggregate number and the percentage of the class of securities owned by the purchaser; and (6) a description of any contracts, arrangements, understandings or relationships regarding the securities of the issuer.

The Commission continues to support more rapid disclosure of accumulations of securities that could result in a change of control transaction. Indeed, the Commission is considering additional methods of improving its regulatory requirements in this area. The Commission's staff is considering recommending that the Commission publish for public comment rule amendments to require persons subject to Section 13(d) filing requirements who have a passive investment intent to file Schedule 13G-type disclosure. Adoption of amendments along these lines could affect the potential impact of certain legislative proposals currently under consideration on the operation of Section 13(d).

The Commission could also support legislation to require that a Schedule 13D be filed within five business days of crossing the 5 percent threshold, and that a prohibition on further purchases be imposed until the filing requirement is satisfied. 5/ While the filing window should be closed, a 1 or 2 day reporting requirement may impose significant compliance costs and logistical problems for some acquiring persons. It would create the potential for numerous technical violations of the rule where reports could not be prepared and transmitted in time to meet the filing deadline. Moreover, it would apply not only to securities professionals but also to nonprofessional investors who may engage in such transactions only infrequently.

This standstill-until-filing proposal prevents acquirers from using the 13(d) window to increase their holdings substantially without public notification. It achieves this result while avoiding potential liability for stockholders with complex holding structures who may inadvertently violate a 24 hour mandatory disclosure requirement.

The ability of market participants to trade freely is an important federal policy underlying the Williams Act's scheme of regulation and, therefore, a standstill requirement should be limited to the minimum period necessary to assure effective disclosure under Section 13(d). The Commission could support a standstill only until the required filing has been made. Under this approach, the acquiring person would control the length of time the standstill is imposed -- an immediate filing would allow the resumption of acquisitions immediately thereafter. Such a standstill would provide an incentive for prompt filing, allow the purchaser sufficient time to prepare and file a disclosure statement without disadvantaging other investors who have not yet been fully informed of material information regarding the markets for the securities.

5/ An exception should be considered for de minimis changes in positions during this mandatory standstill.

B. Groups Within Definition of "Person"

S. 1323 and S. 1324 would expand the statutory definition of "person" to broaden the concept of a group for Section 13(d) purposes. S. 1323 would explicitly include two or more persons "acting in concert or in a coordinated or consciously parallel manner (whether or not pursuant to an express agreement)" and would also address groups seeking to "influence the management or policies of an issuer." S. 1324 would provide that a group need not be organized and that the Commission or a court may rely on action "in a consciously parallel manner, without regard to the existence of a contract or agreement," in determining whether two or more persons act as a group. S. 1323 would make parallel amendments to Section 14(d). 6/

Existing Commission rules are sufficiently broad to address arrangements or understandings that are not written or express. Rule 13d-5 covers those situations in which two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of securities. Knowingly parallel conduct already constitutes evidence of an agreement under Section 13(d). For example, the courts have held that the fact that an investor knows that he is acting through his broker, along with other clients of that broker, to form a block for the benefit of the entire group, is evidence that all the clients were acting together. 7/

Moreover, the proposed language of these provisions would unnecessarily complicate the administration of Section 13(d). It would introduce from the very different area of antitrust law a new, vague complex, and controversial concept, "conscious parallelism." In any case, S. 1323, which would permit establishment of a group solely upon proof of consciously parallel conduct, is inappropriately broad. It would prohibit trading activities merely because two or more traders consciously anticipated without any discussion that they and perhaps others have adopted similar strategies. In the extreme, such a definition would reach traders who buy or sell simply on the basis of publicly available information, such as significant changes in reported volume, or newspaper articles suggesting that others were buying or selling. Thus, coordination or interdependence should continue to be a necessary

element to establish the existence of a group under Section 13(d), and the Commission would not oppose legislation consistent with this standard. The introduction of a statutory definition based on "conscious parallelism" is unwise.

C. Additional Disclosure Requirements

The proposals include several provisions that would add to or increase the specific disclosures required by Section 13(d). The proposed amendments are intended to address what the sponsors describe as the "recent phenomenon of modern pools" -- *i.e.*, transactions in which investment bankers, institutions, arbitrageurs, and others join in takeover activities. Accordingly, S. 1323 would require that persons subject to Section 13(d) reporting requirements disclose any communications with a third party in the 90 days prior to the filing regarding the filing person's intention to purchase securities that are the subject of the filing person's statement, if that third party either has filed a statement under Section 13(d) or 13(g) or, to the knowledge of the filing person, subsequently acquired, or agreed to acquire, such securities. S. 1324 would require disclosure of certain information about any person to whom the purchases were disclosed or with whom they were discussed. Both S. 1323 and S. 1324 would require disclosure of information relating to the financing of the purchases, including the identity of the lenders and a summary of the financing agreements, and fees.

S. 1323 would also require the Commission to provide a means by which persons would be required to specify whether their intention in acquiring the securities was for control or investment. Both S. 1323 and S. 1324 would prohibit a person who disclosed an investment intent from making a tender offer for the securities until 6 months after filing an amendment disclosing control intent, unless the Commission exempted the transaction due to a material change of circumstances resulting in a change in the purpose for which the securities were held or acquired.

The Commission does not believe that additional disclosure of contacts with third parties is necessary. Item 6 of Schedule 13D, "Contracts, Arrangements, Understandings or Relationships with Respect to Securities of the Issuer," already requires filing persons to describe any contracts, arrangements, understandings or relationships among members of a group or with any person with respect to any securities of the issuer. Requiring disclosure of all contacts with third parties would encompass a large volume of communications not intended to be addressed, present significant impediments to compliance, and result in unnecessary disclosure. For example, such a requirement would extend to communications by subordinate employees of a filing entity, and communications to persons acting on behalf of the filing person.

6/ The Commission believes that any amendment that may be made to the statutory definition of "person" in Section 13(d)(3) should also be made in Sections 13(g)(3) and 14(d)(2).

7/ *See Champion Parts Rebuilders, Inc. v. Cormier Corporation*, No. 86 C 8906 (N.D. Ill. April 9, 1986); *Jacobs v. Pabst Brewing Co.*, 549 F. Supp. 1050 (D. Del. 1982).

These requirements would, moreover, impose difficult, if not impossible burdens on filers of Schedule 13D. To avoid liability, a filer would have to determine whether anyone with whom he has had relevant communications has filed a statement under Sections 13(d) or 13(g). In addition, litigation could result over whether an acquiring person knew, or should have known, that a person with whom he communicated subsequently acquired securities. These burdens would be imposed even though the persons included in the communications did not constitute a group. This potential for liability could seriously chill legitimate communications among clients, investment bankers, and others who, for any number of legitimate reasons, may be purchasing or selling securities subject to a 13D filing in the 90 day period before a filing is made.

With respect to the proposed disclosure requirements concerning financing and fee arrangements, the Commission concurs that disclosure of material information regarding a possible takeover is necessary and appropriate. Legislative action in the area, however, may not be necessary. Much of the information called for by the proposals is required to be reported pursuant to current Schedule 13D disclosure requirements, including Item 3, "Source and Amount of Funds or Other Considerations," Item 6, "Contracts, Arrangements, Understandings or Relationships with Respect to Securities of the Issuer," and Item 4, "Purpose of Transaction." If, however, Congress believes that additional disclosure is necessary, the Commission could require, through rulemaking, disclosure of additional relevant information, without imposing increased disclosure burdens on persons where the information may not be particularly useful -- e.g., those investors who have a truly passive investment purpose.

In addition, the Commission believes that imposing a 6 month bar from conducting a tender offer on persons who disclose an investment intent is not necessary to serve the disclosure purposes of the statute. There are many legitimate reasons why an investor would acquire a position for investment purposes and, within six months of filing a Schedule 13D, decide to conduct a tender offer or otherwise attempt to influence corporate control. Investors who misstate their investment intent are subject to liability for a false filing with the Commission, which could result in money damages or a Commission enforcement action. The Commission does not support this proposed legislation.

D. Reduced Filing Threshold

S. 1323 and S. 1324 propose to reduce the threshold ownership level that triggers the Section 13(d) filing requirement. S. 1323 would reduce the reporting threshold from 5 percent to 3 percent. S. 1324 would reduce the threshold to 2.5 percent. (S. 227 would maintain the current 5 percent threshold.) Proponents of lowering the threshold suggest that it will serve the same purposes as the reduced filing period, i.e., that "such filings will more timely alert the marketplace to large, rapid accumulations of target company shares."

Lowering the reporting threshold could result in earlier disclosure of possible control contests. However, a lowered threshold would impose substantial costs, both by reducing the ability of a bidder or dissident shareholder to obtain a "toehold" position from which to commence a tender offer or proxy contest, and also by increasing the number of persons subject to the filing requirement and the number of amendments filed.

As originally adopted, Section 13(d) set the reporting threshold at 10 percent. In 1970, Congress reexamined this issue and reduced the Section 13(d) reporting threshold to 5 percent. In 1980, at the request of Congress, the Commission studied the issue and concluded that the 5 percent threshold was appropriate and should be maintained. This conclusion was based in part on a concept release published by the Commission to request public comment on whether the threshold should be reduced. 8/

In addition, ownership of a block less than five percent is rarely sufficient to convey control over a publicly traded corporation. The five percent threshold thus serves as an effective trigger for requiring public notification and disclosure. Based upon these considerations, and the comments received in response to the comment process, the Commission concludes that lowering the five percent threshold would generate costs in excess of benefits, and would not materially advance the legitimate public disclosure purposes of the Williams Act. In addition, the adoption of other proposed amendments concerning Section 13(d), outlined above, would adequately address the concerns underlying the proposal.

E. Elimination of Exemption for Persons Purchasing Less than 2 percent in 12 months

Both S. 1323 and S. 1324 would eliminate the existing exemption from the Section 13(d) filing requirements for acquisitions which, together with all other acquisitions by the same person of securities of the same class during the preceding 12 months, do not exceed 2 percent of the class. Under the statute's present

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8/ At that time, the Commission estimated that reducing the threshold to 2 percent would result in a 175 percent increase in initial filings made with the Commission, and a reduction to 1 percent would result in a 394 percent increase. Decreasing the threshold would also have an impact on the total volume of amendments filed. In fiscal year 1986, the Commission received over 7000 initial Schedule 13D's and amendments.

operation such persons are not totally exempted from filing but rather are obligated to file pursuant to Section 13(g) when they reach the 5 percent ownership level. The disclosure required from persons filing under Section 13(g) is less comprehensive than that required from persons filing under Section 13(d). The less detailed disclosure is warranted for persons who are less likely to seek a change of control through acquisition of shares because of the limited nature of their purchases. Therefore, the Commission does not support this proposed change.

F. Filing Period for Amendments

S. 1323 and S. 1324 would amend Section 13(d)(2) to provide that amendments to Schedule 13D filings that reflect material changes in the information previously disclosed be filed with the Commission no later than the first business day after the change occurs. The Commission's Rule 13d-2 currently requires that such amendments be made "promptly."

The Commission believes that no legislation is necessary in this area. A fixed statutory time period for filing amendments is not appropriate. The requirement that disclosure statements be promptly amended has been interpreted in a number of recent Commission opinions. 9/ Flexibility is necessary to adapt the requirements to a wide range of circumstances. For example, in the context of a contest for control by competing bidders, an amendment should be filed as soon as possible after the change. On the other hand, a less stringent amendment requirement may be appropriate for institutional investors, such as pension funds and investment companies, which alter positions in their portfolio securities on a daily basis, and for investors with solely a passive investment purpose.

The specification of such requirements should therefore be accomplished through continued case law development or rulemaking. As previously noted, the staff is considering a possible rulemaking initiative that would differentiate the filing and disclosure requirements applicable to those persons who have acquired shares with a purpose to seek control from those who have only a passive investment purpose.

S. 1324 would also deem a change in beneficial ownership amounting to 1 percent of a class of equity securities to be a

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9/ See In re Revlon, Inc., Exch. Act Rel. No. 23320 (June 16, 1986); In the Matter of Centrust Savings Bank Exch. Act Rel. No. 23076 (March 31, 1986); In the Matter of Cooper Laboratories, Inc., Exch. Act Rel. No. 22171 (June 26, 1985).

material change requiring amended disclosure. The Commission's Rule 13d-2 already requires such disclosure.

II. SECTION 14(d) - TENDER OFFER REGULATION

A. Tender Offers 10/

1. Minimum Offering Period

S. 1323, S 1324 and S. 227 would all extend the minimum offering period for tender offers. S. 1323 would require a minimum offering period of 35 business days; S. 1324 would require 45 business days. S. 227 provides for different minimum offering periods depending on whether the offer is for all shares and whether it is an initial or subsequent offer. The minimum period for an initial offer under that bill would be 30 calendar days.

The proponents urge that an extension of the minimum tender offer period is necessary to provide an opportunity for target company shareholders to receive tender offer materials and make an informed investment decision before tendering shares. In addition, they argue that a longer time period would permit the board of directors of a target company to evaluate the offer fully without existing time constraints and would increase the likelihood of an auction and higher premium being paid to shareholders. Opponents of the legislation argue that extending the minimum time period favors target company management at the expense of the bidder by allowing management more time to put defensive measures in place for the purpose of entrenching itself.

The Commission believes that the present minimum offering period prescribed by Commission rule is adequate for investor protection. Current Commission Rule 14e-1(a) establishes a minimum offering period of 20 business days. That minimum period is supplemented by Rule 14e-1(b), which requires that a tender offer remain open for at least 10 business days from the date that notice is provided of an increase or decrease in (1) the percentage of the class of securities being sought, (2) the consideration offered, or (3) the dealer's soliciting fee. The offer must also remain open to permit adequate disclosure and dissemination following other material changes in the information in tender offer materials previously provided to security holders. The minimum time period an offer must remain open following a material change varies depending on the facts and circumstances, including the degree of significance of the information and the manner of dissemination. Generally, the offer

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10/ S. 1323, S. 1324 and S. 227 each contain provisions to amend the title of Section 14 to reflect the fact that the provisions of the section concern tender offers as well as proxies. The Commission supports this change.

should remain open for a minimum of five business days from notice of a material change. 11/

Present federal regulation of tender offers embodies a Congressional determination that the federal securities laws should protect investors through means that are neutral as among bidders and the target corporation. The present 20 business day period is intended to be consistent with this objective, while ensuring full disclosure of material information and providing sufficient time for shareholders to review that information.

The 20 business day minimum offering period is the product of a lengthy rulemaking proceeding extending over a period of 3 years, during which two separate proposals were published for comment and over 200 letters of comment were received. The Commission originally proposed a minimum tender offer period of 15 business days to "alleviate undue pressure on shareholders without unduly hindering the bidder making a tender offer." 12/ Partially in response to the comments received on these proposals, the Commission published revised proposals, including a 30 business day minimum tender offer period. 13/ Finding persuasive the views of commentators who indicated that a minimum 30 business day period was unnecessarily long, the Commission concluded that the objective of investor protection could be satisfied with a 20 business day minimum offering period. 14/

11/ *See* Securities Exch. Act Release No. 24296, 52 Fed. Reg. 11,458 (1987). Based on information maintained by the Commission's Directorate of Economic Policy and Analysis and compiled by the Office of the Chief Economist, 28% of the 285 successful tender offers during 1985 and 1986 were open the minimum time period. The offering period for 35% of the offers was over 25 business days.

12/ Securities Exch. Act Release No. 12676, 41 Fed. Reg. 33004, 33009 (August 2, 1976).

13/ Securities Exch. Act Release No. 15548, 44 Fed. Reg. 9956 (February 5, 1979).

14/ In adopting this minimum offering period, the Commission noted that the purposes of the Williams Act "do not . . . include the promotion of competing tender offers which normally result in increasing the consideration paid for the securities being sought." Securities Exchange Act Release No. 16384, 44 Fed. Reg. 70326 (November 29, 1979) (citing the testimony of Philip A. Loomis, Commissioner, SEC Hearings on Regulation Under Banking and Securities Laws of Persons Involved in Corporate Takeovers, Before the Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong., 2d Sess. 87 (1976)).

Similarly, the Commission has acted to extend proration and withdrawal rights, out of concern that more time was needed by shareholders to evaluate the offer. Proration rights and withdrawal rights are now coextensive with the term of the offer.

In the Commission's view, the current minimum offering period, particularly in light of the extension requirements, provides adequate time to allow shareholders to evaluate and respond to tender offers. 15/

2. Substantial Open Market or Privately Negotiated Purchases and Partial or Two-Tier Tender Offers

S. 227, S. 1323, and S. 1324 each include provisions that would mandate compliance with tender offer requirements based upon the extent of beneficial ownership of the securities that a purchaser would acquire. S. 1323 and S. 1324 would apply the tender offer regulatory scheme to all acquisitions that result in ownership of more than 15 percent or 10 percent of a class of equity securities, respectively. S. 227 would apply tender offer regulation to acquisitions of more than 2 percent of a class in a 12-month period once the purchaser acquires beneficial ownership of 20 percent of the class.

While the provisions of the three bills differ in some respects, they all seek to apply rules designed to regulate tender offers to all substantial purchases of securities. They would thus foreclose the ability of an investor to acquire or to dispose of a block of stock over the proposed threshold through open market or privately negotiated transactions, regardless of the purpose of the transaction.

Two of the bills, S. 227 and S. 1324, also would limit or discourage the use of partial and two-tier tender offers. S. 1324 would prohibit such offers by making it unlawful for any person to acquire more than 20 percent of a class of an issuer's equity securities unless the purchaser makes a tender offer for all remaining shares at one price and on the same terms. S. 227 would discourage such offers by requiring persons making a tender offer for less than all outstanding shares to hold such offer open for a period of at least 40 calendar days, while an offer for all of the securities in the class would only have to remain open for 30 calendar days. While S. 227 would regulate the mode

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15/ If the minimum offering period for tender offers is extended, the time period should be defined by reference to business days, and not calendar days, to provide a uniform standard for the application of the time periods.

of acquisition, S. 1324 would preclude partial ownership over a certain level.

If enacted, these provisions would mark a dramatic departure from the historic role of federal securities regulation in the marketplace, which has sought to ensure investor protection with minimal interference with business transactions and the generally free transferability of securities. Even individually, these provisions would radically change the nature of corporate ownership and securities transactions in this country, and would do so by forbidding transactions wholly unrelated to the hostile takeovers that underlie this Committee's concerns. The provisions of S. 1324 would effectively eliminate the acquisition and ownership of any greater than 20 percent partial interest in public corporations. Further, S. 1324, like S. 1323, would prohibit privately negotiated transactions or block trades on the open market resulting in ownership of over the specified percent of a corporation's equity securities. Similarly, S. 227 would preclude significant open market or privately negotiated purchases by a more than 20 percent holder. Such dramatic changes in the operation of the markets are not warranted.

The Commission believes that the principal concern in this area is the ability of issuers, bidders and others to take advantage of the market conditions created by a tender offer or an announcement of the intention to commence an offer. The market conditions created often result in large blocks of stock accumulating in the hands of arbitrageurs. Issuers or bidders may then quickly purchase the arbitrageurs' holdings, bypassing the tender offer process. 16/ The Commission's staff is currently drafting a proposed rule to address these transactions -- which have become known as "market sweeps." Such a proposed rule would prohibit all persons, including the issuer, from purchasing more than a specified percentage (*e.g.*, 10 percent) of a company's securities during a specified period (*e.g.*, 10 days) following termination of a tender offer, unless the purchases are conducted by a tender offer. 17/

16/ Examples include: Carter Hawley Hale Stores, Inc.'s 1984 repurchase of 50% of its outstanding common stock during a tender offer by The Limited, Inc.; Hanson Trust PLC's 1985 acquisition of SCM Corporation, and Campeau Corporation's 1986 acquisition of Allied Stores. Other similar transactions include: Dixon Group PLC's 1987 acquisition of Cyclops Corporation and Amalgamated Sugar Co.'s 1986 acquisition of NL Laboratories.

17/ The prohibition would apply from the date a tender offer is commenced or a bidder makes a public announcement including the information specified in Rule 14d-2.

Market sweeps can create the same pressures on shareholders that the Williams Act was intended to alleviate. Widespread market sweeps could render the tender offer process a sham device to concentrate shares in relatively few hands, where they can be acquired without the costs and competitive risks of complying with the tender offer rules. Courts have not treated such purchases as unconventional tender offers or as ineffective terminations of ongoing tender offers, and thus have declined to apply federal tender offer regulation to such acquisitions. 18/

The legislative proposals, however, reach beyond market sweeps to regulate all substantial acquisitions and ownership of public corporations. No evidence of abuse has been put forward that would justify a prohibition on the acquisition of over 20 percent of a company, without making a tender offer for all the remaining shares. There are many sound and practical justifications for partial acquisitions. For example, partial acquisitions allow companies to make equity investments with less than 100 percent financial exposure; they facilitate technological changes and relationships; they facilitate venture capital, foreign and other direct investments; and they permit investors to become familiar with potential acquisitions before deciding to increase their investment. Partial ownership is not inherently abusive and state law fiduciary standards regulate the conduct of a partial owner of a controlling interest vis-a-vis the other shareholders in the company.

If the proposed limitation on partial tender offers is intended to regulate the alleged coercive effect of two-tier tender offers, 19/ the market appears to have corrected any problem that may have existed. Two-tier offers appear to be waning without federal intervention: in 1982, 18 percent of all offers were two-tier offers; in 1983, 21 percent were two-tier offers; in 1984, 9 percent were two-tier offers; in 1985, 4 percent were two-tier offers; and in 1986, 3 percent were two-tier offers.

18/ *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47 (2d Cir. 1985); *SEC v. Carter Hawley Hale Stores, Inc.*, 760 F.2d 945 (9th Cir. 1985).

19/ A "two-tier" bid involves an acquisition of all oustanding shares that is accomplished in two steps. In the first step, the bidder uses a tender offer to buy a controlling position in the target. Once control is established, the offeror will engage in a second step business combination, usually a merger, taking out the minority shareholders with consideration frequently valued at a lower price than the original tender offer price.

Another discipline operating on two-tier offers are "fair price" charter amendments that generally require bidders to pay to remaining shareholders, in the second step of a business combination, a price that is at least equal to that paid to obtain shares in the first step. Hundreds of corporations have adopted such provisions. Moreover, at least 14 states have adopted such requirements by statute. 20/ In addition, there is evidence that two-tier tender offers do not have the coercive effects often alleged. 21/ For these reasons, the Commission continues to believe that a federal policy prohibiting or inhibiting partial or two-tier tender offers is both unneccessary and undesirable.

Moreover, it has not been demonstrated that open market purchases present abuses sufficient to justify requiring all substantial acquisitions to be conducted by tender offer. Indeed, it is not clear that control can easily be obtained in the open market in the absence of a tender offer or an announced intention to commence one. 22/ Without such evidence, Congress should not alter the thrust of federal tender offer legislation from regulating tender offers to regulating all substantial acquisitions.

In 1983, the Commission's Advisory Committee on Tender Offers recommended that changes be made similar to those now proposed in the pending legislation. 23/ The Commission has declined to support the recommendation, concluding that it "is

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20/ Indeed, two-tier bids may now be more a management defensive technique than a hostile bidder tactic. Address of SEC Commissioner Joseph A. Grundfest, Two-Tier Tender Offers: A Mythectomy, Before the United Shareholders Association, June 15, 1987.

21/ *See* Office of the Chief Economist, SEC, "The Economics of Any-or-all, Partial, and Two-tier Tender Offers" (April 19, 1985).

22/ The open market purchase programs conducted by Sir James Goldsmith to acquire Crown Zellerbach, Inc. and by Carl Icahn to acquire TWA are often cited as examples of the need to regulate all substantial acquisitions. However, the Goldsmith takeover involved actual commencement of a tender offer, while the Icahn takeover involved an announcement of an intent to conduct a tender offer. Moreover, it should be noted that both acquisitions extended over several months: 8 months in the case of Crown Zellerbach and 4 months in the case of TWA.

23/ *See* Advisory Committee on Tender Offers, Report of Recommendations 22-23 (July 8, 1983).

not necessary for the protection of shareholders and impedes legitimate open-market purchase programs." 24/ Recently, in testimony before the Subcommittee on Antitrust, Monopolies and Business Rights of the Senate Judiciary Committee, the Commission expressed the view that legislation subjecting all substantial acquisitions to tender offer requirements "would represent a significant departure from the present regulatory scheme and therefore raise substantial questions about the appropriate nature and scope of federal tender offer regulation." 25/

The Commission continues to oppose such legislation. The Williams Act was not intended to impose restrictions on all substantial purchases of stock. Rather, the statute properly created a dichotomy between the regulation of tender offers under Section 14(d) and the post-acquisition disclosure of other purchases of substantial amounts of stock under Section 13(d). Tender offers place pressures on shareholders to determine whether to sell their shares that are not present in normal open market and negotiated transactions.

The proposed legislation would discourage investors legitimately interested in partial ownership of a corporation, including persons interested in providing venture capital or other financing, from accumulating substantial amounts of stock. Due to monetary, legal and logistical burdens of complying with the tender offer rules, persons seeking to make a significant passive investment in a corporation might be forced either to abstain or to increase the magnitude of their purchases to make the effort worthwhile.

Moreover, the proposals would hinder the ability of investors to dispose of blocks of stock. In the absence of an exemption, they could not sell their blocks to any one person unless that person complied with the tender offer requirements, including, under the prohibition of partial offers in S. 1324, conducting a bid for all of the corporation's stock. If the blocks were dismantled and the shares sold in the market, investors could be deprived of the full value of their holdings. In addition, other

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24/ Letter, dated January 17, 1986 from John Shad, SEC Chairman, to the Honorable Timothy Wirth, Chairman, House Subcommittee on Telecommunications, Consumer Protection and Finance. *See also* Statement of John Shad before the House Subcommittee on Telecommunications, Consumer Protection and Finance, March 28, 1984.

25/ Statement of Charles C. Cox, Commissioner of the SEC before the Subcommittee on Antitrust, Monopolies and Business Rights of the Senate Judiciary Committee, April 2, 1987.

shareholders may suffer, as stock prices may decline after blocks of stock are sold into the open market.

Proponents of these provisions urge that all shareholders should receive a premium when control of a company is sold, because control is a corporate asset belonging to all shareholders. [26] There is no evidence justifying such a significant departure from long-standing principles of state corporate law. [27] Prompt disclosure of large-scale purchases enables shareholders to sell in the open market, at a price reflecting the possible shift in control, or attempt to negotiate a private transaction with the person seeking to increase his holdings.

The proposals also would make it more difficult for shareholders to succeed in a proxy contest. Often, insurgent shareholders need to acquire a significant, though not necessarily controlling, amount of stock in order to succeed. Under the proposed provisions, insurgent shareholders would be considered a group and therefore any purchases beyond the specified level would have to be in compliance with tender offer requirements. S. 1324 would cap the level of ownership an insurgent group could acquire at 20 percent, since any further acquisition would require a tender offer for all outstanding shares. The additional costs associated with a tender offer would discourage such acquisitions and thereby discourage proxy contests. Moreover, the additional time required to make such purchases through the tender offer process would make it difficult to consummate such purchases before a shareholder meeting unless the proxy contest is initiated considerably in advance of the shareholder meeting. The overall effect of restraining creation of substantial blocks may be to enhance the position or management at the expense of shareholders.

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[26] E.g., 133 Cong. Rec. 470 (January 6, 1987) (remarks of Senator D'Amato).

[27] See, e.g., Delano v. Kitch, 663 F.2d 990, 995, 998 (10th Cir.), cert. denied, 456 U.S. 946 (1981) (under Kansas law, "[c]ontrol of a corporation is not a corporate asset, and the majority shareholders are not required to share with the minority shareholders any premium received for control"); Swinney v. Keebler Company, 480 F.2d 573, 577 (4th Cir. 1973) ("Generally, the owner of corporate stock may dispose of his shares as he sees fit"); Christophides v. Porco, 289 F. Supp. 403, 405 (S.D.N.Y. 1968) ("Control is not a corporate asset, but is rather an attribute of stock ownership. There is no obligation * * * to 'share and share alike'"); Essex Universal Corporation v. Yates, 305 F.2d 572, 576 (2d Cir. 1962) ("There is no question of the right of a controlling shareholder under New York law normally to derive a premium from the sale of a controlling block of stock").

3. Tender Offer Disclosure

a. Summary Disclosure

S. 227 would require bidders to provide security holders with "summary disclosure" of the material terms of the offer and information about the offeror. The Commission currently requires disclosure of all the information specified in the proposed amendment. Current tender offer practice is to highlight the key terms of the offer in a summary section, with further detail provided in the body of the offering circular. If Congress determines that such a specific requirement should be imposed, it should be implemented by the Commission under its present rulemaking authority.

b. Community Impact Statements

S. 1324 would require bidders in the tender offer process to file an economic impact statement indicating whether the acquiror intends to sell or close any facilities, terminate any operations, and abide by collective bargaining agreements. The bidder would also be required to estimate the number of employment positions likely to be lost, and to estimate revenue losses to local government entities. In many instances, the bidder would lack the information to make such estimates prior to taking control of the company. The Commission has not supported this type of disclosure as a part of the federal securities laws because the information is not directly relevant to the purpose of investor protection -- the facilitation of informed investment decisions. In short, the disclosure would be directed to the wrong audience. Adopting a provision in the federal securities laws to require a community impact statement in disclosure documents would therefore depart from the purpose of these statutes, and would often not result in meaningful further disclosure.

B. Defensive Tactics

Legislative proposals introduced to date are not limited to the regulation of bidders' conduct; most of the proposals also seek to curtail or eliminate certain practices developed by management as defenses to takeover attempts. S. 1323, S. 1324, and S. 227 would each prohibit issuers from repurchasing stock from persons who have held substantial quantities of shares for a limited period of time. These proposals would limit the practice known as "greenmail." S. 1323, S. 1324, and S. 227 would also prohibit issuers from entering into agreements during a tender offer increasing their officers' and directors' compensation. These proposals are intended to control the use of "golden parachutes." Finally, S. 1323 and S. 1324 would limit issuers' ability to adopt "poison pill" plans. They would prohibit issuers from granting rights during a tender offer that would entitle the holder to purchase securities of the issuer or any other corporation at less than their market value. S. 1324 would also limit an issuer's ability to grant rights requiring the issuer to repurchase its securities at greater than market value.

The Commission is opposed to federal legislation that would prohibit these defensive tactics. The regulation of matters such as the use of corporate assets to repurchase the issuer's shares, the compensation of corporate officers and directors, and the propriety of board of directors' action to authorize such payments or implement other devices to prevent a change in corporate control, are matters of corporate governance, traditionally subject to state law. If a board of directors fails to fulfill its fiduciary obligations to shareholders, appropriate remedies are available under state doctrines of corporate waste and breach of fiduciary duties.

The Commission understands the sentiment against "greenmail." The large number of highly publicized repurchases in the past year prompted the Commission to decide in early 1987 to reconsider its 1986 decision to recommend no federal action to regulate or control such payments. Nonetheless, the Commission still believes that it would be an inappropriate intrusion into matters traditionally governed by state law to enact a federal prohibition against such purchases. A more appropriate federal response would be the use of disclosure mechanisms to alert the remaining shareholders to a substantial securities repurchase. Currently, such payments may be made unannounced prior to a tender offer or even before a five percent position has been accumulated. Disclosure could be required, by rule, either before the purchase is consummated 28/ or shortly after the transaction. 29/

The issue of whether there should be federal regulation of "poison pills" has been particularly troublesome. The Commission, out of concern that poison pills could pose a virtually insurmountable barrier to hostile tender offers and could impair the ability of shareholders to wage hostile proxy contests, took the unusual step of filing an amicus curiae brief in Delaware state court in the *Moran v. Household International* litigation, 30/ to express

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28/ Such disclosure could be required in the manner used in Rule 14f-1, which requires disclosure of the background of a bidder's nominees to the board 10 days prior to their appointment as directors following a takeover.

29/ Such disclosure could be required pursuant to the periodic reporting requirements of either Form 8K (used for current reports under Section 13 or 15(d)) or Form 10Q (used for quarterly reports under Section 13 or 15(d)).

30/ 500 A.2d 1346 (Del. 1985).

its views with respect to the effect of such plans. Subsequently, the Commission issued a Concept Release seeking information on whether a governmental response to poison pill plans is necessary or appropriate. The Commission expressed the view in the Concept Release that many of these concerns might be resolved if these plans were subject to shareholder approval, noting that such a requirement could be imposed at either the state or federal level.

Commentators on the poison pill issue in the Concept Release were fairly evenly divided in their views as to the need for regulation, especially at the federal level. Twenty-three commentators favored prohibition of poison pills, and 13 commentators supported shareholder approval of poison pill plans. Sixteen commentators expressly opposed or found inappropriate any federal action in the poison pill area, while 6 other commentators suggested that regulation of such plans be left to state law.

The Commission does not support federal regulation of poison pills. Recent experience shows that the courts will entertain legal challenges to the adoption of such plans. The courts have invalidated plans found to have been adopted without authority under state law or in violation of state fiduciary obligations. 31/ It thus appears that investor concerns raised by poison pill plans are being addressed under state corporate law.

With respect to golden parachutes, some have characterized them as an abuse, while others have urged that golden parachutes can serve to align the interests of management with those of shareholders during a contest for control. The adoption of golden parachutes does not present a significant problem in the tender offer process and there is no basis for preemptive legislation in this area.

Furthermore, the specific provisions of S. 1323, S. 1324, and S. 227 that pertain to defensive tactics would not eliminate

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31/ *Buckhorn, Inc. v. Ropak Corporation*, 656 F. Supp 209 (S.D. Ohio), *aff'd*, 815 F.2d 76 (6th Cir. 1987); *Dynamics v. CTS Corp.*, 794 F.2d 250 (7th Cir. 1986), *on appeal from remand*, 805 F.2d 705 (7th Cir. 1986); *Amalgamated Sugar Company v. N.L. Industries*, [1986] Fed. Sec. L. Rep. (CCH) ¶ 92,857 (S.D.N.Y. 1986); *Princeville Development Corp. v. Spinner Corp.*, Civil No. 86-0701 (D. Haw. Oct. 31, 1986); *R.D. Smith & Co., Inc. v. Preway, Inc.*, No. 86-C-641-C (D. Wisc. Sept. 26, 1986); *Asarco, Inc. v. M.R.H. Holmes A Court*, 611 F. Supp. 468 (D.N.J. 1985); *Minstar Acquiring Corp. v. AMF Inc.*, 621 F. Supp. 1252 (S.D.N.Y. 1985); *Unilever Acquisition Corp. v. Richardson - Vicks, Inc.*, 618 F. Supp. 407 (S.D.N.Y. 1985).

these practices. The greenmail provisions, which look to prices measured over a 30 day period would not eliminate greenmail; they would merely regulate the price at which greenmail occurs. Because the 30 day average price can be greater than current market price, the anti-greenmail provision of S. 1323 would actually allow greenmail payments at above-market prices. Further, proposals linked to market price can create an incentive for the bidder and management to attempt to inflate the market price of the stock in order to allow a buyout at "market," but nevertheless at a substantial profit to the bidder. Thus, a substantial incentive for greenmail would continue to exist under the present proposals.

The golden parachutes and poison pill provisions contained in the legislation would also be largely ineffective because they would not deter parachutes and pills adopted prior to a tender offer. Many corporations already have golden parachutes and poison pills in place, and other corporations could adopt these practices without shareholder approval prior to a tender offer and still not violate the proposed legislation. For example, as of April 1986, 387 of the "Standard & Poor's 500" companies had agreements or policies providing for such compensation; 40 percent of the "Fortune 500" companies have similar provisions in place. Similarly, poison pill plans are generally adopted before the tender offer commences. 32/ Any harm caused by poison pill plans occurs whether the plan is adopted during or prior tr the commencement of a tender offer.

III. FINANCING OF TENDER OFFERS

A. Debt or Contingent Financing

S. 1324 would prohibit hostile third party tender offers for the equity securities of an issuer if: (1) more than 25 percent of the consideration offered is to be directly or indirectly obtained from borrowings or the issuance of debt, and (2) it is reasonably expected by the issuer that any of its assets will be relied upon to secure or service the debt. S. 1324 contains an additional provision intended to prohibit the use of "highly confident" letters by investment banking firms, by prohibiting tender offers in which any or all of the consideration offered is cash unless, at the time when the offer is announced, either the funds are on deposit at a bank or trust company or the bidder

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32/ A recent study by the Investor Responsibility Research Center showed that approximately 30 percent of the "Fortune 500" companies have already adopted "posion pills."

has entered into irrevocable commitments with banks or trust companies to provide the cash.

As a matter of policy, the Commission does not support artificial restrictions on the availability of credit. Such restrictions would constitute merit regulation of financing vehicles and techniques, an approach at odds with the traditional philosophy of the federal securities laws, when there is little evidence calling for such a credit restriction in any regard. 33/

Neither does the Commission believe that requiring a bidder to have firm financing before commencing a tender offer is necessary or desirable. Advocates of such restrictions assert that they would reduce the incidence of "illusory" offers designed to put the company into play or result in greenmail, and increase the likelihood that announced offers will be completed. There is no evidence, however, that the practice of contingent financing has resulted in illusory offers or any other abuse. To the contrary, experience has shown that the market evaluates the nature and extent of a bidder's financing in assessing the probability that an announced takeover attempt will be consummated.

Moreover, requiring financing to be committed prior to commencement of an offer is unlikely to deter most bidders. Currently, there is a large market for acquisition capital. For example, investment banking firms generally are prepared to finance an acquisition on a short-term basis. Because loans to finance acquisitions are a high yield activity, other institutions also will advance the required capital. Hence, firm commitments prior to commencement of the offer could be obtained, and the effect of the requirement in most situations would simply be to increase commitment costs. In addition, attempts to specifically regulate debt issued for the purpose of financing a tender offer may easily be circumvented by bidders who divert funds from other uses to finance the bid, borrowing to finance the other activities that would have otherwise been paid for with cash, or obtaining initial financing in an equity form that is later converted to debt.

33/ Measured at market value, the average debt-equity ratio of nonfinancial corporations for the period 1973 - Jan. 1987 was 73.36 percent, with a peak of 91.1 percent in 1974 and a trough of 60.4 percent in 1980. As of January 1987, the aggregate debt-equity ratio stood at 66.6 percent, about 6.5 percentage points below the average for this fifteen year period. Source: Board of Governors, Federal Reserve System, Capital Markets Section, Division of Research and Statistics.

B. Studies of High-Yield Non-Investment Grade Debt

Two of the bills, S. 1324 and S. 227, would require governmental studies of various issues relating to high-yield, non-investment grade debt financing. The matters to be studied include the identity of issuers and purchasers of such debt, their distribution system and secondary market, the relationship between issuers, investors and underwriters of bonds used to finance takeovers, the role of commercial banks and investment banking firms in financing takeovers, the relative amount of such debt being used for purposes other than takeovers, increases in corporate debt relative to equity capital, and the adequacy of existing state and federal laws regulating investment in these instruments. The Commission has no objection to such a study. Irrespective of the appropriateness of merit regulation of such securities, the Commission recognizes that the federal government has an interest in this subject, including the determination of whether these instruments are appropriate investments for federally insured institutions. The Commission also believes that, before any action is taken to restrict the use of such securities, it is critical that Congress be fully informed of the variety of roles they play in the economy.

IV. MANAGEMENT LEVERAGED BUYOUTS AND GOING PRIVATE TRANSACTIONS

S. 1324 would prescribe additional requirements applicable to management leveraged buyouts and going private transactions. It would provide that 60 days must elapse between the day the proposed acquisition of an issuer by officers, directors or employees is publicly announced and the day the proposed acquisition occurs. S. 1324 also would require that the purchaser obtain a report prepared by a court-appointed "independent appraiser" who would "review the terms of the proposed acquisition." The analysis of the bill explains that the report must address "the fairness of the valuation of the company."

As indicated above, 34/ the Commission does not believe that such a lengthy period as 60 days is necessary for informed shareholder decision-making. In addition, the vast majority of leveraged buyouts and going private transactions involve a tender offer or proxy solicitation and therefore will be subject to the regulations governing such transactions. 35/ It does not appear to be necessary to isolate tender offers and proxy solicitations that are part of leveraged buyouts and impose disclosure and timing requirements for such transactions that differ from those applicable to all other tender offers and proxy solicitations.

34/ See supra pp. 10-12.

35/ See Regulations 13E, 14D and 14E (tender offers); Regulations 14A and 14C (proxy solicitations and information statements) under the Exchange Act.

In adopting Rule 13e-3, the Commission left to state law substantive fairness requirements and followed the approach of full disclosure that has traditionally guided federal regulation of securities transactions. 36/ The Commission believes that present Rule 13e-3 adequately serves the purposes of the proposed appraisal requirements, without mandating fairness opinions or appraisals. For example, virtually without exception, reports from outside parties are obtained in leveraged buyouts, and Rule 13e-3 mandates that such reports be disclosed and summarized and, if written, filed with the Commission. In addition, the purchaser must state whether he believes that the transaction is fair or unfair to unaffiliated security holders. If any directors dissented or abstained from voting on the transaction, their identities and the reasons for the dissents or abstentions must be disclosed. Moreover, mandated disclosure of financial information concerning the issuer enables security holders to make their own assessment of the fairness of the transaction from a financial point of view. And as with any tender offer, underpriced bids may attract a higher priced offer.

In addition, the need for court involvement in the appointment of the required appraiser would, at the least, be cumbersome. Shareholders can assess the independence of any appraiser who provides an opinion, since all fees and conflicts of interest must be disclosed.

36/ Rule 13e-3 applies to any transaction or series of transactions by an issuer or an affiliate of an issuer, including leveraged buyouts, if the transaction causes the issuer's equity securities to be held of record by fewer than 300 persons, to be delisted from a national securities exchange or to cease to be authorized for quotation on an inter-dealer quotation system. If a transaction is subject to the rule, Schedule 13E must be filed with the Commission and disseminated to all shareholders of the issuer. Among other things, the Schedule requires disclosure with respect to: (1) the identity and background of the purchaser; (2) past contacts, transactions, or negotiations between the purchaser and other persons concerning mergers or acquisitions regarding the issuer; (3) plans or proposals of the purchaser; (4) the source and amount of funds or other consideration to be used in the transaction; (5) the purpose and effects of the transaction on the issuer and its security holders; and (6) whether the transaction is fair or unfair to unaffiliated security holders, including whether or not the purchaser has obtained any report, opinion, or appraisal from an outside party relating to the transaction.

V. REMEDIES AND PENALTIES

A. Government Actions for Civil Penalties

S. 1324 would make it unlawful for a person who fails to file a statement or information required under Section 13(d) to purchase any additional securities of the class that is the subject of the filing until the statement or information is filed. S. 1324 also would provide monetary penalties for failure to file any statement required under Sections 13(d), 13(f), and 13(g) of the Exchange Act, and for materially false and misleading filings made pursuant to those sections. [37]

The bill would impose a "forfeiture" or civil penalty of at least $1,000 per day on a person who has failed to make a required filing. Where a filing has been made but is materially false or misleading, the provision subjects the person making the filing to a penalty of the greater of one percent of the market value of the equity securities covered by the filing for each day it remains materially false or misleading, or the difference between the highest market price of the equity security during the 10 trading days immediately following the filing of a corrected statement and the lowest market price for the security after the false or misleading filing but before the filing of a corrected statement. [38] The penalty may be assessed on a showing that the violation was "not inadvertent." [39] The Commission is also given the authority to exempt by order any failure to file if it deems the exemption consistent with the public interest and the protection of investors.

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[37] Section 13(f) requires certain institutional investment managers to file reports with the Commission. *See*, *infra* n. 41.

[38] The second portion of this provision appears to address only those situations in which the filing of a corrected statement results in an increase in the price of the security. Presumably, the provision is also intended to address situations in which the corrected filing results in a *decrease* in the price of the security.

[39] A defendant in a suit to recover a forfeiture may be entitled to a jury trial. *See* *Tull v. United States*, 107 S. Ct. 1831 (1987). Jury trials are not required in injunctive actions brought by the Commission to address violations of the sections cited by S. 1324.

Currently, the Commission may bring an injunctive action or an administrative proceeding based upon a failure to file a statement, or the filing of a false or misleading statement required by these sections. The Commission may obtain appropriate ancillary relief tailored to the circumstances of each case, in addition to the entry of an injunction. In administrative proceedings, the Commission may require the filing of a corrected statement or other steps to effect compliance with the violated provision. Settlement of administrative proceedings may also involve relief similar to that obtained as ancillary relief in injunctive actions.

The Commission believes that the sanctions and remedies available through the equitable jurisdiction of the courts are largely adequate. Upon an appropriate showing, the Commission can already obtain an order "sterilizing" shares acquired in violation of Section 13(d), as well as other forms of relief. To be effective, however, sterilization of votes should not be an extraordinary remedy, but should be available in the discretion of the court whenever the facts and circumstances warrant.

The Commission also believes that monetary penalties for violations of Section 13(d) would be useful in addition to remedies currently available. Considerations in setting such a penalty should include whether the violation occurred with scienter, and whether the violation led clearly to a financial gain by the party who made the incorrect or late filing. The legislation should set a maximum figure up to which courts would be able to determine an appropriate penalty. This would take into account varying degrees of culpability and give the Commission greater flexibility in ensuring compliance with the filing requirements. In setting the statutory maximum, however, it should be noted that the penalty may be viewed simply as a minor incremental cost of doing business if set too low. [40]

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[40] The Commission recommends that the statutory provision explicitly state that any new actions authorized would be in addition to any other actions the Commission and the Attorney General are authorized to bring and any other remedies that a district court, exercising its equitable jurisdiction, could provide.

B. Private Rights of Action

S. 1323 would provide express private rights of action for violations of Sections 13(d), 13(f) and 13(g) of the Securities Exchange Act, and the rules and regulations thereunder. 41/ It would also create a private right of action for violations of Section 7 of the Exchange Act, and the rules and regulations thereunder, in connection with the financing of a tender offer or other acquisition of equity securities to obtain or influence control of an issuer. The bill would allow an action by an issuer of the securities involved "or any other person aggrieved in his business or property" by reason of a violation of those sections. The proposal would allow private plaintiffs to recover actual damages, including costs and reasonable attorneys fees, and to seek equitable relief including an order compelling divestiture of the securities acquired in connection with the violation, an order enjoining the voting of such shares, or an order enjoining the making of a tender offer or other attempt to acquire control. The bill provides that violations resulting from a "bona fide error notwithstanding the maintenance of, and compliance with, procedures reasonably necessary to prevent such violations," would not lead to liability for monetary damages.

41/ Section 13(f) and Rule 13f-1 thereunder generally require institutional investment managers exercising investment discretion with respect to accounts holding certain publicly traded equity securities with an aggregate fair market value of $100 million or more on the last trading day of any of the twelve months of any calendar year to file Form 13F with the Commission providing specified information relating to those holdings. The form must be filed within 45 days after the last day of such calendar year and within 45 days after the last day of the first 3 calendar quarters of the subsequent year.

Section 13(f) was intended to create in the Commission a central repository of historical and current data about the investment activities of institutional investment managers. The creation of a private right of action under Section 13(f) would raise issues beyond the purposes of the proposed legislation. Accordingly, the Commission assumes that references to Section 13(f) in the bills' provisions concerning private rights of action are unintended.

S. 1324 contains provisions similar to those of S. 1323 with respect to Section 13. It does not, however, provide for a private right of action with respect to Section 7. However, it contains an additional provision that a person bringing suit based on a false or misleading statement in violation of Section 13(d), (f) or (g) need not show actual reliance on the misrepresentation or omission, but only that the plaintiff did not have knowledge of the facts misrepresented or omitted and that there is a substantial likelihood that a reasonable investor would have considered the facts significant.

The Commission has, on a number of occasions, filed briefs amicus curiae urging the courts to find an implied right of action under Section 13(d), on behalf of the issuer and its shareholders, to obtain injunctive relief. All United States Courts of Appeals that have considered the question have found an implied right of action by issuers and their shareholders to seek injunctive relief under Section 13(d). 42/

With respect to the remedies available to such persons, the Commission has also urged, and most courts of appeals have held, that a broad range of equitable relief is available to private plaintiffs to remedy violations of Section 13(d), including not only corrective disclosure but also such remedies as an order prohibiting a person in violation of Section 13(d) from soliciting proxies or an order enjoining the voting of wrongfully acquired stock. 43/ The Commission has argued that a court may enter

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42/ *See, e.g.*, *Gearhart Industries, Inc. v. Smith International, Inc.*, 741 F.2d 707 (5th Cir. 1984). However, some district courts have found that no private right of action exists under Section 13(d).

The Commission has also argued, and the courts of appeals have found, that a private right of action exists under Sections 14(d) and 14(e) of the Williams Act. *See, e.g.*, *Gearhart Industries, Inc. v. Smith International Inc.*, 741 F.2d at 707 (5th Cir. 1984); *Electronics Specialty Co. v. International Controls Corp.*, 409 F.2d 937 (2d Cir. 1969).

43/ *See, e.g.*, *General Aircraft Corp. v. Lampert*, 556 F.2d 90 (1st Cir. 1977). The Eleventh Circuit Court of Appeals, however, has recognized a private right of action under Section 13(d) only to obtain corrective disclosure. *See Florida Commercial Banks, Inc. v. Culverhouse*, 772 F.2d 1513 (11th Cir. 1985).

whatever equitable relief may be necessary in a given case to protect investors, in light of the purposes of the Act, and that in some circumstances corrective disclosure may not be adequate to correct Section 13(d) violations and to deprive the violator of the fruits of his wrongdoing.

Thus, the existence of an implied right of action on the part of an issuer and its shareholders under Section 13(d) is well established, and the courts have awarded appropriate relief depending on the circumstances of the case. Accordingly, legislation to provide an express right of action is unnecessary.

The issue of whether a private right of action should exist for violations of Section 7 of the Exchange Act, governing the use of credit in the purchase of securities, raises a different set of issues. In recent years, the courts of appeals that have considered the issue have held uniformly that there is no implied private right of action for a violation of Section 7. Section 7 is primarily designed to prevent economic disruption by regulating the credit markets. The use of debt financing in any one transaction does not influence aggregate economic leverage in a fashion that reasonably implicates the interests of a specific target or its shareholders. Further, an express private right of action would present particular concerns in the tender offer context since it might function simply as a tool in the hands of issuers for defeating debt-financed offers; even if the courts are diligent to guard against suits intended merely for this purpose, shareholders could be harmed by the delays associated with the litigation. In view of these concerns, the Commission does not support creation of express rights of action for issuers and their shareholders under Section 7.

VI. MARKET REGULATION

A. Registration and Regulation of Tender Offer Arbitrageurs

S. 1323 would amend the Exchange Act to define the term "tender offer arbitrageur" and would broaden the current definition of a "dealer" found in Section 3(a)(5) to include

tender offer arbitrageurs. 44/ Since dealers in securities must register with the Commission pursuant to Section 15(b), the legislation would effectively require only registration of any tender offer arbitrageurs that are not already registered with the Commission.

The Commission believes that most major tender offer arbitrageurs are currently registered with the Commission as broker-dealers. Not only are their activities likely to cause them to fall within the present definition of a dealer, there are significant business incentives for tender offer arbitrageurs to register as broker-dealers. As registered broker-dealers, tender offer arbitrageurs may execute trades without using another broker-dealer, thus avoiding commission charges that would make many low margin transactions impractical. Also, exchange membership, which requires broker-dealer registration, affords direct

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44/ Certain persons that might otherwise fall within the language used to define a tender offer arbitrageur would be excluded. These persons include natural persons, registered investment companies, and employee benefit plans that are subject to the fiduciary regulations under Section 401 of the Employee Retirement Income Security Act of 1974. The Commission believes that were this proposal to be enacted, the exclusions would be appropriate. Individuals, acting solely on their own behalf, have not traditionally been significant participants in tender offer arbitrage. Registered investment companies and employee benefit plans are already subject to systems of regulation that address many of the concerns underlying this provision. If the application of these proposed provisions to other entities, such as insurance companies, would not be necessary to address the concerns of this legislation, the exemptive authority provided in the definition of tender offer arbitrageur would afford the Commission sufficient flexibility to grant appropriate relief.

The Commission also recommends that, if the proposed definition is adopted, the securities covered by the definition be expanded to include all equity securities that exceed the current minimum asset and shareholder requirements for reporting companies under Section 12(g)(1) of the Exchange Act and the rules thereunder.

The CHAIRMAN. Thank you very much. The entire statement will be printed in full in the record, as will the entire statement of Mr. Sprinkel.

I should have noted, Mr. Cox, that you are the current Acting Chairman of the SEC and you have a reputation for being strong on enforcement and we welcome your testimony today. I thought you did a fine job before the committee the other day. You were challenged and I thought you did very well indeed.

Mr. Cox. Thank you.

The CHAIRMAN. Commissioner Cox, again, your statement is brilliant but evasive. Sixty eight percent of those polled in the country support tougher regulation of hostile takeovers. The securities industry itself supports additional regulation. The corporate community and labor and the States support our taking some action. And yet the Commission only supports closing the 10-day window; tightening the definition of a group; a study of high-yield, noninvestment grade debt; and monetary penalties for violations of section 13(d).

NEGATIVE ATTITUDE OF COMMISSION

How do you account for the Commission's negative attitude on this critical issue?

Mr. Cox. Well, I don't think that it is a negative attitude. I think that the 13(d) area and that disclosure is very important and that's why we submitted our suggestion for requiring faster disclosure and a standstill for the purchases until that disclosure has been made.

But I guess in a broader response to your question that you just posed, I really believe that a number of provisions of these bills today go much further than the tender offer process. Specifically, I'm speaking about the requirements that any purchases over a 10, 15 or perhaps 20 percent level be made through a tender offer. There are a lot of transactions in the market that involve block purchases and a lot of block holders that buy and sell positions that have nothing to do with tender offers.

So my remarks about a substantial impact on the capital markets are really directed at those kinds of proposals that aren't even in the area of takeovers but that somehow would be put in that area by the suggestions that are in the bills.

The CHAIRMAN. Well, as I understand it, the Commission's own Tender Offer Advisory Committee suggested this action on tender offers, that when you get to 15 percent you have to make an offer to all shareholders.

Mr. Cox. Yes, as I recall, there was a suggestion such as that. The Commission considered it and believed that that was not in the interest of shareholders.

The CHAIRMAN. Several times in your statement you argue that some of the legislative proposals before this committee would be better handled by SEC regulation and you indicated in some cases the Commission is thinking about adopting a regulation to curb corporate takeover abuses.

The abuses stemming from corporate takeovers have been widely known for several years and yet, despite the overwhelming evidence, the Commission has done virtually nothing. Indeed, it has even disavowed many of the recommendations of its own handpicked Tender Offer Advisory Committee whose members reflect the views of the Wall Street establishment.

Now given the track record of the Commission over the last few years, why should this committee and the Congress have any confidence that corporate takeover abuses will be addressed by the Commission?

Mr. Cox. Well, I think that we have addressed a number of areas: The all holders and best price rules that were put in place by the Commission. We made a suggestion about considering the idea of prohibiting substantial purchases during or shortly following a tender offer. We will be considering a recommendation for a rule regarding that in July. We put that concept out for comment. It's been through the comment process. The Division of Corporation Finance is preparing a rule proposal for our consideration. I think that that is a very important step.

So that I guess I disagree, Chairman Proxmire, that we've been doing nothing. I think we've been considering the different areas and reacting where we saw investors were threatened.

The CHAIRMAN. Senator D'Amato.

OPENING REMARKS OF SENATOR D'AMATO

Senator D'AMATO. Thank you very much, Mr. Chairman, and let me say that I'm pleased that we have this hearing and to see Mr. Sprinkel and Mr. Cox here. I want to assure Commissioner Cox that I am not going to ask him if he hasn't prepared all these changes for this hearing, but I'm looking forward to August 3 when we get a definition from the Commission as it relates to insider trading.

Mr. Cox. Yes, sir.

Senator D'AMATO. Mr. Chairman, I'm going to ask that my full statement be included in the record as if read in its entirety and I'm not going to take the time to ask our distinguished panel any questions but would like to summarize some observations.

No. 1, in recent years it has become rather fashionable and particularly for some very respected leaders in the business community to attempt to create a mythology surrounding corporate takeovers that bears as much resemblance to reality as the mythologies of ancient Rome and Greece. They are myths, but they are popular and the media plays on them, and some of our colleagues in the Congress play upon them. I understand that. I understand parochial interests and needs and concerns when a company is about to be acquired. All types of corporate activity can cause social and economic dislocation and so we want to help those who may be displaced.

Notwithstanding that, to attempt to lump all of the evils that one finds today in the business community as it relates to corporate takeovers is just plain wrong.

Myth No. 1. Corporate securities laws are a panacea to all the problems of the world. Like the chairman and members of this committee, I recognize that certain changes must and should be made as a matter of fact. I have suggested some changes in the past and I believe that some will be enacted. Notwithstanding that, I think that basically the Williams Act has stood us well in the test of time because its well-balanced legislation. As stated in the language accompanying the final legislation balance is a laudable goal. In relevant part the report states: "The committee has taken extreme care to avoid tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid." It goes on to say that the bill is designed to require full and fair disclosure for the benefit of investors while at the same time providing the offerer and management equal opportunity to fairly present their case. I think that's really what we want to attempt to seek to maintain.

Do we have to make some changes in present law? I think some can be made.

Myth No. 2. Corporate takeovers cost us jobs and productivity. The fact of the matter is, if we look in those areas where we've seen the greatest activity in corporate takeovers—the transportation area, the mining area, and the computer industry and others—we've seen in certain areas dramatic cutbacks and in others we have seen the competitive forces where we've had very dramatic increases—and I'm not going to go into detailing them, I do in my statement include those. For example, trucking and warehousing employment has increased by 16.5 percent since 1982. Employment in air transportation, one of the areas where we've had mergers and acquisitions, 117,000 additional jobs, or an increase of 26.3 percent. Even in mature and slow growth industries such as retail grocery stores, which has been a tremendous plethora of activities in this area of mergers and acquisitions, we see employment increase of 385,000 or a 17.7 percent, and on and on the list goes.

So to simply say that we lose jobs as a result of takeovers and no good comes of them is really an overstatement. It's a myth, but we feed on it. If you repeat it often enough and enough responsible people continue to mindlessly adopt these beliefs, then the myth takes on its own life and some semblance of reality.

Myth No. 3. The need to abolish coercive tactics such as two-tier offers—while that may seem to be something that we should certainly explore, if one looks at the evidence we'll find that indeed the two-tier offer has not been used widely in the past 2 years and has been used indeed by corporate defenders as a method by which to fend off takeovers and also in terms of their own leveraged buyouts within-house.

Myth No. 4. Restructuring brought on by corporate takeovers has adversely affected American industry. I think if you'll look at the empirical evidence, it simply does not demonstrate this to be a fact.

I'm going to conclude by saying that while I believe that the fraudulent and manipulative practices attendant to takeovers, engaged in by certain scoundrels, certainly have to be eradicated, I don't believe that the abolition of corporate takeovers which some would seem to be suggesting is really the answer to these problems.

I thank the chairman for his patience and I commend him for bringing forth this legislation so that we can have a dialog and so that we can explore these areas of concern.

[The complete prepared statement of Senator D'Amato follows:]

Statement of Senator Alfonse M. D'Amato
Before the Senate Banking Committee
Contests for Corporate Control:
Myth vs. Reality
June 23, 1987

In recent years I have witnessed many respected leaders of the business community attempt to create a mythology surrounding corporate takeovers that bears as much resemblance to reality as the mythologies developed by the ancient Greeks and Romans.

Myth Number 1: The Corporate Securities Laws are a Panacea to All the Problems of the World

First, I want to make it clear that the realities of corporate takeovers require some amendments to the Williams Act. However, we must be careful to ensure that these amendments are consistent with the purposes of the Williams Act, in particular, and with the federal securities laws, in general. Therefore, the first myth I would like to debunk is that the federal securities laws should go beyond their original purpose of protecting shareholders and promoting investor confidence through the maintenance of fair and orderly markets.

In fact, Senator William's initially proposed a scheme designed to impede corporate takeover activity. Congress rejected this approach by choosing a "judgment neutral" regulatory approach. With the enactment of the Williams Act, Congress acknowledged that hostile tender offers provided potential benefits to shareholders and the economy as a whole. I think the authors of the William Act correctly assessed their situation and the one which we face today in the report language accompanying the final legislation.

> "The Committee has taken extreme care to avoid tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid. The bill is designed to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management equal opportunity to fairly present their case."

I believe that any effort to impede corporate takeovers, no matter what the supposed rationale is unwarranted. Such legislation represents an implicit judgment by Congress that takeovers are evil. No empirical evidence presented to the Committee supports such a finding. Further, Congress should not begin the practice of micro-economic engineering through the federal securities laws.

Myth No. 2: Corporate Takeovers Cost us Jobs and Productivity

First, let me say that I understand that corporate takeovers create temporary dislocations in the work force. However, I think it's safe to say that more jobs are created and lost in New York City and probably throughout the country due to normal economic trends than are created and lost due to corporate takeover activity. For example, the automobile industry, the telecommunications industry, the computer industry and others have seen dramatic job cutbacks in recent years. Little, if any, corporate takeover activity has occurred in these industries.

Competitive market forces in a capitalist society, rather than corporate takeovers have resulted in job losses in these sectors. More jobs are lost to our foreign competitors each year than can be attributed to job loss attendant to corporate takeovers. Therefore, corporate takeovers have been used as a type of scape goat for the job losses that have occurred for reasons totally unrelated to corporate takeover activity.

To support my claim, I can cite some statistics provided by the Department of Labor. For example, while employment losses may be taking place in some companies due to merger or consolidation activity, employment often continues to expand at a brisk pace in other new or existing companies within the same industry. The net effect, from an aggregate industry employment perspective, is often one of intra-industry employment shifts rather than an absolute decline in the number of available jobs. For example, employment in trucking and warehousing has increased by 16.5 percent since 1982. Similarly, employment in the air transportation industry is up by 117,000, or 26.3 percent. Even in a mature and slow growth industry such as the retail grocery business (in which acquisition activity has been active), employment has increased by 385,000, or 17.7 percent since 1982.

The one group whose jobs are clearly at stake and who suffer the most from takeovers are corporate managers. The higher ranking the manager, the more severe the job loss. I empathize with these corporate leaders because, like them, I am subject to a Constitutionally mandated hostile takeover every six years. However, rather than complain about the system, I try to excel within it through constantly ensuring that my varied constituencies are satisfied. That is why I find it hard to accept the stated rationales opposing takeovers from those corporate managers who would abolish takeover activity to save their own necks. These managers are the same ones who seek protection from the Japanese and other foreign competitors; protection from corporate takeovers; and protection from their own shareholders, the people who actually own the company.

Finally, one point on managements concerns about the so-called "dilemma" shareholders experience where confronted by a corporate takeover. Corporate shareholders are the one group that has fared well as a result of takeover activity. Management is so concerned about the shareholders' dilemma that many of the most vociferous advocates of takeover reform are the most willing to disenfranchise their own shareholders. These corporate leaders are at the forefront of the movement away from the one-share/one vote capitalization standard for no legitimate reason other than to insulate management from shareholders. This attempt to disenfranchise shareholders is the real dilemma confronting shareholders.

Myth No. 3: The Need to Abolish Coercive Tactics Such as Two-tier Offers

Recent data I have received from the SEC reveals that the nasty reputation that two-tier offers have gotten as being a tool misused by corporate raiders is undeserved. This data reveals that two-tier offers have been used with ever increasing frequency to thwart all cash hostile offers.

Surprisingly, the data suggests that two-tier bids have become all but extinct as a hostile takeover device in the past two years. Two-tier bids have, however, gained increasing popularity as a defensive technique. They are also used as a management leverage buyout technique and as a means of financing friendly takeovers supported by target management. Therefore, to the extent that two-tier bids represent a coercive tactic, such coercion may now be practiced more by corporate managements that hostile raiders.

Recently introduced legislation criticizes two-tier techniques when used by bidders. This legislation claims to be evenhanded because it seeks to limit "egregious defenses as well as coercive takeover tactics." However, this legislation is silent about the potential for coercion when essentially identical techniques are used by management. To the extent that legislation relating to two-tier offers is motivated by concern over shareholder coercion but addresses only hostile bids, and does not address coercion arising from management defensive maneuvers, questions are raised about the completeness, logic, and purpose of such legislative proposals.

Myth No. 4: Corporate Restructuring Brought on By Corporate Takeovers Have Adversely Affected By Corporate Takeovers

Recent empirical evidence suggests that corporate restructuring has helped America's global competitiveness. Since 1981, when the takeover boom began, there has been an impressive improvement in the productivity of the manufacturing and mining sectors of our economy. Since 1981, 50% to 65% of all takeover activity has occurred in the manufacturing and mining sectors. During the 1980-1986 period, productivity in these industry segments where restructuring was particularly intense appears to have out-performed the rest of the economy where restructuring was less intense.

This has been accomplished because restructuring has redeployed limited capital and assets to more productive uses. These figures demonstrate that takeovers are more than a mere shuffling of paper as ownership changes, but rather reflect fundamental alterations in the deployment of assets which have induced major improvements in productivity. Thus, corporate debt is not such a bad thing if it is used for productive purposes, it becomes an evil if it is wasted on unnecessary acquisitions or endeavors designed to satisfy the egos of corporate managers rather than to maximize productivity and shareholder wealth.

Conclusion

While I believe that the fraudulent and manipulative practices attendant to takeovers practiced by certain scoundrels on Wall Street merit eradication, I do not believe the abolition of corporate takeovers is the way to address those problems. Where certain abuses exist, such as sweeping the street or creeping offers that can be addressed by procedural changes to the Williams Act, they must be addressed. I believe that a close student of corporate takeovers will agree with, or can at least cite support for, the conclusion that takeovers provide net economic benefits for the country. Further, the economic case against corporate takeovers has just not been made in the Congress. Therefore, I would find it hard to support most of the current legislative initiatives in the Senate Banking Committee because, despite the claims of their authors, these bills will have a chilling effect on takeover activity.

access to the exchange floor, allowing arbitrageurs to adjust their positions easily in response to price fluctuations.

The Commission recognizes that there are many so-called "hedge funds" that control significant capital and may, at times, engage in risk arbitrage. However, the Commission does not believe, at this time, that trading by these entities has resulted in the specific abuses that are sought to be addressed by this legislation. Registration as a securities dealer entails, among other things, being subject to examination and the Commission's net capital rules, compulsory association with a self-regulatory organization, and detailed recordkeeping. Without evidence that these entities have been the source of abuses associated with tender offer arbitrage, the Commisison believes that imposing the burdens of registration has not been justified.

B. Trading Halts

S. 1324 would amend Section 12(k) of the Exchange Act to prohibit any broker or dealer from effecting transactions in a security subject to a trading suspension, imposed by the security's primary market, to facilitate the dissemination of material information concerning the issuer, the security, or the market for the security. The bill further provides that such a trading suspension would be limited to one day unless extended with Commission approval, and provides that such a suspension would be subject to review by the Commission on its own motion, or upon the request of any adversely affected issuer, broker, dealer or self-regulatory organization. The Commission would have the authority to exempt a broker or dealer or class of brokers or dealers from the trading prohibition. In addition, the proposed legislation would require the Commission to define the term "primary market."

Such legislation would create uniform procedures among the securities markets. Currently, the National Association of Securities Dealers, Inc. has procedures that halt only the dissemination of quotations in securities, pending the dissemination of material information ("quote halts"). Quote halts do not halt, however, NASD members' trading of either over-the-counter ("OTC") or listed securities. [45]

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[45] The NASD recently filed with the Commission a proposed rule change to add procedures for halting its members' trading pending dissemination of material news. This proposal is under consideration. *See* Securities Exch. Act Release No. 24176 (March 4, 1987), 52 Fed. Reg. 7718.

The Commission questions, however, whether such an across-the-board trading halt is desirable. Currently, when a primary market halts trading so that information can be disseminated, the parties who engage in off-board, "third-market" transactions are predominately large, sophisticated investors, aware of the uncertainty related to the trading halt. These investors seek to reallocate among themselves the risk inherent when the market anticipates an announcement. Third market participants are often capable of trading offshore, in London or elsewhere. Therefore, an "all-markets" trading halt may not have the effect desired by Congress.

VII. COMMISSION RULEMAKING AND EXEMPTIVE AUTHORITY

S. 1323, S. 1324, and S. 227 each contain provisions relating to the Commission's authority, including specific provisions that would grant the Commission authority to adopt rules or provide exemptions from the requirements that would be imposed by the bills. Like the Commission's existing authority, these provisions would permit the adoption of rules to implement and detail the means of compliance with statutory requirements, and would permit, by rule or in some cases by order, exemptions for persons or circumstances not intended to fall within their scope.

An express grant of authority, particularly for the purpose of granting exemptions, would appear to be a necessary complement to the proposed new requirements, in view of the rigor of the new proscriptions under consideration, and the additional sanctions and causes of action that would be established. The Commission recommends, however, that the proposed provisions relating to the Commission's authority be incorporated into a single provision to the fullest extent possible. Drafting the authorization in this way would facilitate administration of the bills' provisions and reduce the possibilities for technical problems, including the risk of adoption of inconsistent standards, or inconsistent judicial interpretations of various provisions intended to operate analogously. It would also avoid any unintended negative implications regarding the Commission's authority in areas as to which Congress already has granted such authority. In addition, this rulemaking provision should clarify that the general authority granted to the Commission under the various provisions of the Exchange Act applies equally to the provisions of that Act added by the Williams Act amendments.

VIII. ROLE OF STATE LAW

S. 1323 and S. 1324 would provide that Congress declares that the internal affairs or governance of a corporation shall be subject to regulation by the laws of the state under which it is organized. These provisions would expressly state that nothing contained in Sections 13 and 14 of the Exchange Act, or any rules thereunder, shall be construed to supersede any state law regulating such internal affairs or governance, or, in the case of S. 1323, contests for control of the corporation, except when compliance with the state law would preclude compliance with the filing, disclosure, procedural, or antifraud requirements of Sections 13 and 14. 46/ S. 1324 specifies that this result should obtain even if the state law would affect the ability of any person to cause a change in control by means of a tender offer; it also contains a nonexclusive definition of internal affairs or governance.

The Commission opposes enactment of these provisions. They raise difficult interpretive problems, and the full range of consequences that would result from their adoption is unclear. 47/ The broad authority of the states over matters traditionally viewed as the internal affairs or governance of corporations organized under their laws is well settled. In most respects, the exercise of this authority has served to complement and has operated in harmony with the federal regulation of securities and securities-related transactions. For example, in the proxy regulation area, federal and state regulation is to a large extent concurrent. The adoption of the proposed provisions would interject substantial and unnecessary uncertainties into the operation of this dual regulatory scheme.

The specific purpose of the proposed provisions appears to be to assure the validity of those state statutes relating to the internal affairs or governance of corporations that may affect the operation or success of tender offers that are otherwise governed by the federal regulatory scheme. The Supreme Court addressed this subject in its recent decision in CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637 (1987). In CTS, the Court upheld an Indiana statute providing that shares purchased in a control share acquisition, which in that case was pursuant to a tender offer, are accorded voting rights only to the extent approved by a majority of shares held by disinterested shareholders at a meeting of the shareholders. In reaching this conclusion, the Court found that the statute furthered a basic purpose of the Williams Act and did not conflict with the requirements of the federal tender offer regulatory scheme. The Court also found that any effects that the Indiana statute had on interstate commerce were justified by the state's interests in defining the attributes of shares in corporations organized under its laws and in protecting the shareholders of these corporations.

CONCLUSION

The Commission appreciates the opportunity to testify on pending proposals to amend federal regulation in the corporate takeover area. The Commission would be pleased to provide any further information or assistance that would be of benefit to the Committee in its consideration of this subject.

46/ It is not clear why the scope of these provisions extends to all of the provisions of Sections 13 and 14, including the federal periodic reporting, books and records, internal accounting controls, and filing fee requirements, or the antifraud prohibitions.

47/ The Commission assumes the proposed amendments are not intended to affect the Commission's authority under Section 19 of the Exchange Act to review or modify self-regulatory organizations' rules, including quantitative and qualitative listing standards, even if these rules may affect matters relating to the voting rights of security holders. As the Committee is aware, the Commission has commenced a proceeding to determine whether to adopt a rule under Section 19(c) that would require exchanges and the National Association of Securities Dealers not to list or continue listing any company that issues securities or takes other corporate action that has the effect of nullifying, restricting, or disparately reducing existing shareholder voting rights. The concept underlying this rule has been supported by both the NASD and NYSE. Accordingly, the Commission does not believe any limitation on its current authority to oversee SRO rulemaking under Section 19 is necessary or appropriate.

The **Chairman**. Thank you, Senator D'Amato. At this point, I have statements of Senators Riegle, Dixon, Sasser, Sanford, and Shelby to be inserted in the record.

OPENING STATEMENT OF SENATOR DONALD W. RIEGLE

Senator **Riegle**. Mr. Chairman, I look forward to the testimony today, particularly from our administration and SEC witnesses. For 6 years now they have taken the position that we should do essentially nothing in the tender offer area except close the section 13(d) window.

Meanwhile a consensus seems to have developed, between the securities industry and the corporate community that we should at least do the following:

Extend and clarify the definition of a "group" under section 13(d).

Require that acquisitions of more than a certain threshold of a company's stock be made by tender offer.

Impose stronger penalties and create stronger sanctions for violations of the filing requirements of section 13(d).

And, as far as the securities industry and others are concerned, clarify the definition of insider trading.

I for one have also consistently argued and introduced legislation to prohibit the practice of greenmail.

Many people argue that we should go considerably further and, of course 10 of us have cosponsored legislation which would require increased disclosure and fairness to all shareholders as well as increase the penalties for insider trading violations.

I also look forward to the testimony of our State representative. Given the strong philosophical orientation of many members of this committee as well as of the administration in favor of States rights, I would envision that their testimony will be well received by many Members. At the same time, strong arguments have been made in favor of Federal preemption in this area. I look forward to the testimony of Mr. Sprinkel and Mr. Cox on this particular issue as well as on the many others that have been raised in the legislation we have introduced.

STATEMENT OF SENATOR ALAN DIXON

Senator **Dixon**. Mr. Chairman, I am pleased to be here this morning as the committee begins its hearings on S. 1323, the Tender Offer Disclosure and Fairness Act, sponsored by 10 members of this committee, including me, and other tender offer legislation.

As I have stated before, I believe the takeover area greatly needs reform. All too often, in my view, takeover activity has enriched lawyers, securities companies, those financing the takeovers, and perhaps corporate managements, while substantially weakening the balance sheets of the firms that were taken over, or even threatening with takeovers.

S. 1323 provides a basis for dealing with takeover-related problems, while ensuring that the result is not simply to entrench corporate management, giving stockholders no option if a company is not well run. I do not claim it is a perfect bill. I'm sure there will be changes. However, I do believe it is a good beginning.

I look forward to working with this morning's witnesses and all those interested in this area as the committee works toward reporting strong and fair legislation. Before I close, I would like to note for the committee that one of this morning's witnesses is the distinguished secretary of state for the State of Illinois, my good friend, Jim Edgar. I am sure the committee will benefit greatly from his testimony.

STATEMENT OF SENATOR JIM SASSER

Senator SASSER. Mr. Chairman, thank you for calling these important hearings. We have a tough assignment before us; crafting a bill to address the issue of corporate takeovers will not be an easy task.

On one hand we must balance the need to preserve takeovers as a check on management and to help ensure that shareholders receive a fair return. On the other hand we must end the manipulative and coercive tactics that enable takeovers to be accomplished almost in secret. Tactics which have set the stage for the worst insider trading scandal in our Nation's history. And most importantly, tactics which have resulted in the wholesale leveraging of our corporations and our economy, the needless restructuring of sound and efficient businesses, and hundreds of thousands of lost jobs.

Mr. Chairman, I wish to complement you and your staff, as well as Senator Riegle and his staff, for an excellent job in drafting S. 1323. I cosponsored this bill—I think it's a very good starting point for our work. I also wish to complement my friend Senator Sanford on his bill, S. 1324. It contains many noteworthy and beneficial provisions.

There are four areas on which I believe the committee should focus in developing our final legislative product.

First, I believe that there has to be some gage of the impact of takeovers on our Nation's job producing capabilities and it's communities. I think that a person initiating a takeover should be required to file a "community economic impact statement." Such a statement would lay out to all interested parties, particularly the shareholders, plans for restructuring the company, for abiding by labor agreements, for closing plants and facilities, and for eliminating jobs.

Second, I'm not sure that we are doing everything we can to deter persons who initiate tender offers for abusive and manipulative purposes only, or tender offers which have a coercive effect. We have to make it clear that tender offers are designed to be tools for people who actually want to run companies, and not vehicles for quick profits.

Third, we at least need an exhaustive study done of the financing of takeovers. Corporate debt has increased by $384 billion in 2 years, partly due to takeovers. We need to know what the effect of all this very short-term and very high-cost debt will be on our corporations, on interest rates, on research and development, on employment opportunities and our economy's performace in the next business cycle.

Last, we need to explore the wisdom of expanding private rights of action. If all we are doing is creating more work for lawyers, and more frivolous litigation, I don't think that is a good idea.

Mr. Chairman, thank you for your fine work in assembling such impressive witnesses. I look forward to their testimony.

OPENING STATEMENT OF SENATOR TERRY SANFORD

Senator Sanford. Mr. Chairman, I would like to begin by welcoming our distinguished witnesses. I appreciate your taking the time to appear at these hearings on corporate takeovers and I look forward to hearing the views of our States' representatives, the Securities and Exchange Commission, and the President's Council of Economic Advisers on our outstanding legislative proposals. I am particularly pleased to welcome Dan Bell to these hearings. I believe Mr. Bell is the first North Carolinian to appear before this committee since I have joined it. Dan has been doing an excellent job in the securities division of the North Carolina Secretary of State's office and has recently been chosen to serve as president of the North American Securities Administration Association. I welcome Dan to the committee and commend his excellent testimony to my colleagues attention.

Many of you are already aware of my position on corporate takeovers as one of the bills we will be discussing is a proposal I introduced on June 4.

Over the past 3 years I have watched a worrisome trend develop in the corporate mergers and acquisitions marketplace; a trend whereby a small number of investment bankers, lawyers, and arbitrageurs have chosen to abuse the cherished freedoms of the market by going a few steps too far in pursuing their own self interests. While the very fact that this trend could develop serves to illustrate the inventiveness of our financiers, it also reflects the way in which the laws affecting the takeover process have been slow to adapt to our dynamic financial markets. There is no denying that profit motive and the inventiveness of Americans in all walks of life have been the hallmarks of our Nation's success. Unfortunately, that inventiveness, like anything else, if misdirected and misapplied, can benefit the interests of the inventive at the expense of a great many others.

It is my belief that the corporate raider serves as a case in point. I cannot condone the continued actions of these people who, hiding behind flimsy arguments of ousting entrenched managements and crusading for shareholders' interests, proceed to attack some of our strongest companies and drain shareholder funds through greenmail or wrest control of the target completely only to tear it apart leaving a debt-ridden shell. Will that shell, or its collective parts, be able to compete in global markets with all its cash-flow going to debt service rather than research and development or capital investment? Will that company show any productivity gains to offset the social injustice of ravaged pension plans and tens of thousands of jobs lost? I think that the preponderance of the evidence suggests not.

In putting forward my bill I have tried to address what I believe is at the heart of takeover abuses—the methods of financing takeovers. I contend that if this committee does not address the degree to which takeovers have led to massive debt increases by our corporations or the abuses resulting when a raider can put any company in play with virtually no money at risk, then we will have only looked at the symptoms without treating the real cause of the disease. The cancer of hostile corporate takeovers stems from the tremendous debt incurred as a result of the filing of a tender offer and the manipulation of the market that so frequently accompanies such actions.

Indeed the recent bid for Burlington Industries is a perfect case in point—ever since Asher Edelman filed his tender offer—with, I might add, nothing more than a yet-to-be-arranged "bridge loan" to pay for it—there has been a prolonged battle solely over whose debt Burlington would ultimately have to bear, not whether it would have to take on massive debt. While two separate court decisions yesterday upholding a North Carolina Federal court injunction against Edelman and deny an Edelman motion against Morgan Stanley support Burlington's initial allegations that the entire transaction stemmed from the improper use of inside information and represent a victory for Burlington, the outcome is still a tragedy for the company and its 40,000 employees; Burlington still leaves this battle saddled with over $2 billion of debt while Edelman walks away with almost $100 million for himself.

And what has Edelman done to earn his $100 million? He never demonstrated any ability or interest in running our Nation's largest textile firm and his past management record contains nothing to indicate that he could do a better job of running this company than existing management. He managed to push existing management against the wall and force it to resort to defenses that will, in all likelihood, undo the past 10 years of capital investment and major expenditures for modernization. Nor does Mr. Edelman deserve to be rewarded for making a particularly wise investment or putting his capital at risk—for in this world of "highly confident letters" and "bridge loans," the Asher Edelman's of this world can start this whole takeover train rolling with virtually no capital at risk other than the shares quietly bought up at a lower price before word of any tender offer or stock accumulation hits the streets or the files at the SEC.

It is this incentive for short-term profits of huge proportions that fuels so much of the takeover craze and we simply cannot address the central issues surrounding takeover without focusing on who pays for them and where the takeover profits go.

I also commend the chairman for presenting this distinguished panel of State regulators. I believe that our States are now proving once again to be excellent laboratories for positive change as States like Indiana and North Carolina adopt important and creative legislation to address the problems arising for corporations in those States. I believe we must be very careful in any legislation we enact to ensure that States continue to play the strong role they have traditionally had in matters relating to corporate governance. In this delicate area, we must be very clear where the rulemaking and substantive authority of the SEC ends and the important power of the our States begins.

Mr. Chairman, I look forward to this hearing and the hearings scheduled for the remainder of this week, as I am sure that will help us clarify the issues and the facts surrounding the takeover process. I am confident that we can mark up legislation that will go a long way toward correcting the abuses that pervade the takeover process today—particularly if we do focus on the financing for takeovers and look at the impact the takeover has on all members of our corporate world—managers, employees, shareholders, and the community at large.

STATEMENT BY SENATOR RICHARD SHELBY

Senator SHELBY. Mr. Chairman, I want to commend you for your leadership in quickly calling this series of hearings on legislation focusing on corporate takeovers.

You and my other colleagues who have put forth legislative proposals on this complex subject are also to be commended for your efforts.

For the past decade, a wave of corporate takeovers have swept across the corporate boardrooms of this country. Not limited to merger and acquisition of smaller companies by larger corporations, corporate raiders have ridden the crest of this increasingly hostile wave over many of our Nation's largest, and most well-established corporations.

These activities have forced us to reexamine the corporate takeover process. Clearly, there are abuses which must be corrected.

As we approach these hearings, several concerns should be borne in mind.

One, we must look at the overall effects of merger and acquisition activity on the economy as a whole and on the individual companies and their employees, in particular.

True, many takeovers are beneficial and result in better utilization of resources. Too often, however, these takeovers are particularly harsh and disruptive.

Many hostile takeovers force viable corporations to divert their energy and resources from operating the business to developing tactical defenses and incurring vast amounts of debt, often at the expense of long-term growth.

Under the guise of medicine men and healers proffering elixirs of efficiency, competitiveness, and productivity, these hostile corporate raiders complete their transaction, reap their profits and move on to prey on other entities.

Second, we must examine the procedural aspects of corporate takeovers. It has been our public policy, through enactment of the Williams Act and the implementation of securities regulations, that neither the bidder nor the target company would be favored.

Today, given the rash of new tactics in the takeover game—both offensively and defensely—that balance may be somewhat askew. In fashioning legislative response, we must be careful not to tip the balance unduly toward one or the other.

Third, structural considerations must be addressed. As we all know, corporate governance is within the jurisdiction of both the Federal and the State governments.

While there is much merit in the States having the authority to govern their own corporate citizens, especially in hostile takeover situations, the positive aspects of uniformity in the face of a maze of State statutes must be weighed.

While abuses and anomalies associated with corporate takeovers must be corrected, we must be careful not to impose unnecessary restrictions on either bidders or target companies in the takeover process so as to impede the intended workings and efficiences of the marketplace.

I welcome our witnesses here today and look forward to receiving your comments on these various legislative proposals.

The **Chairman**. Senator Graham.

Senator **Graham**. Thank you, Mr. Chairman.

I don't think anyone here is talking about the abolition of corporate takeovers or creating a castle-like wall against the incumbent management, but rather, attempting to do a serious analysis of what the reality is in the contemporary business setting and see if rules that in some cases are 50 years old are appropriate to that environment.

Let me ask, what do you think, Dr. Sprinkel, are there, if any, defects in the current Federal legislation which relates to the transfer of corporate executive authority?

DEFECTS IN FEDERAL LEGISLATION

Mr. **Sprinkel**. Well, first let me say that I believe that many of these perceived weaknesses should be corrected by the stockholders and by State government.

Senator **Graham**. The question was——

Mr. **Sprinkel**. And you asked Federal and I'm going to respond to that question.

And I have some concerns about greenmail and I know that some of the laws that are being proposed address that issue. Now we look at the data, you would expect that greenmail would be to the advantage of management and to the raider at the expense of other stockholders and therefore might not be a desirable practice. Yet, if you look at the evidence, you can't find much evidence to the effect that it affects stockholders very much. If it is something that needs remedy, I would much prefer to see it done at the State and by the corporation itself rather than the Federal.

It's very difficult in these particular cases to have all of the information that addresses a particular proposal and to have it at the Federal level. We need to have it down where the action takes place and that means stockholders and it means States and I think in most cases it does not mean the Federal level.

Senator **Graham**. So the answer to the question is, there are no defects or imperfections in the current Federal law relative to the transfer of corporate executive management that you consider to be appropriate?

Mr. **Sprinkel**. The best evidence that I know of indicates that attempts to take over companies results, on the average—not for each and every case, you cannot identify them ahead of time—results in increasing stockholder wealth, results therefore in increasing the wealth of the Nation, leading to better allocation of resources. And, therefore, I would be very reluctant to say that we should decrease the efficiency of a highly efficient capital market by putting Federal impediments in this process.

Senator **Graham**. Well, then, would that answer not then argue that maybe there are current standards that should be repealed?

Mr. **Sprinkel**. Possibly, but I'm not so arguing.

Senator **Graham**. Are there any that you would suggest that we should consider?

Mr. **Sprinkel**. For repeal? No, sir.

Senator **Graham**. By what standards do you think we should evaluate the current appropriateness of Federal corporate takeover statutes and regulations?

Mr. **Sprinkel**. Well, my own view is that it should be evaluated on the basis of whether or not the action taken by the Congress is likely to lead to a better allocation of resources and therefore a higher standard of living for Americans or whether it works in the opposite direction.

It's very easy to change the ground rules for a market and say you're not hurting anything, but to make that conclusion I believe you have to look at the evidence. And there is a lot of evidence on this particular issue, scientific studies done by academics around the country, by judges, by various other people that have studied the issue and, therefore, I think you should look at that evidence as a guide to what kind of change you should make.

Senator **Graham**. Are there any recent examples of hostile corporate takeovers which you would suggest as being models of their contribution to the economic efficiency of the enterprise or, in contrast, models that raise concerns that we might look to for at least anecdotal information for reform?

Mr. **Sprinkel**. Well, some of them, of course, turn out to be wrong in hindsight, but you never know that until it's over. Therefore, I am not arguing that every merger is a good thing after we know all the facts.

Most of the studies that I'm aware of have looked at the good ones and the bad ones and concluded, on average, it's had a positive effect on promoting proper allocation of resources.

Now one area that's been especially important with respect to hostile takeovers in recent years has been segments of the economy that are undergoing serious structural adjustments. The takeovers have in many cases facilitated those structural adjustments, leading to a reallocation of capital to other areas, leading in some cases to benefits resulting from having larger companies rather than smaller companies. I've spent a lot of time in recent years looking at the European economy and I can assure you that their ability to adjust is severely reduced relative to our own. Therefore, increasing rigidities in an economy and preventing resource move is a sure way to lead to low job creation, low growth as is occurring in most of Western Europe where they have not created a net job in over a couple of decades.

So I'm very concerned that we not move in that direction in the areas that have been especially beneficial, and many of them have been hostile takeovers are in the sectors of the economy where important structural adjustments are occurring. That includes airlines, railroads. It includes various other parts of the economy where change is inevitable.

Senator GRAHAM. The question was, could you cite an example of a positive case in a hostile takeover that you think is a good example of the economic objectives that you believe should be the standard of evaluation, and suggest a negative case that might be used as a cadaver for further autopsy?

Mr. SPRINKEL. The study that I have read looks at them in aggregate and that's what I stated at the beginning. And, therefore, they do not look at each individual one, nor have I looked at individual examples of good ones and bad ones.

The CHAIRMAN. Senator Graham, your time is up. Thank you, Senator Graham.

I'm going to ask Senator Metzenbaum to come forward.

STATEMENT OF HOWARD METZENBAUM, U.S. SENATOR, STATE OF OHIO

Senator METZENBAUM. I am very grateful to you and very grateful to Mr. Sprinkel and Mr. Cox for permitting me to intervene. I will not be lengthy.

Mr. Chairman, the subject of these hearings is an urgent one. I want to applaud you and the committee and your staff for introducing takeover reform legislation that attempts to balance the competing interests of bidders, management, shareholders, and employees. I particularly commend you, Mr. Chairman, for your leadership. Your bill, S. 1323 is an excellent start.

As one who has had an opportunity to work with you on this legislation, I'm aware of the complexity of the responsibilities that you have and admire the effort that you have made.

The bill is not perfect and I do have some suggestions, but it is a major step in the right direction toward a bill that is balanced and fair.

Now while capital should flow freely, it also should flow fairly. What the takeover mania has shown is that in all too many cases capital does not flow fairly. Takeover abuses, such as greenmail, poison pills, golden parachutes, insider trading, and the like, too often line bidders and arbitrageurs' pockets and save managers' jobs, but they do precious little for the corporation, the shareholders who own it, or the community which depends on it.

Mr. Chairman, you and this committee recognize that the stakes are too big for Congress to sit idly by any longer. Congress must act now. Soon the takeover issue will be off the front page, off the nightly news. Unless we act now, the opportunity will be gone.

Now the SEC's position stated today, I'm frank to say, is disappointing. But in view of its pending action vitiating the right of all shareholders to have equal voting rights, one is forced to raise the question as to whose side the SEC is on, both with respect to their testimony today and with respect to the matter of vitiating the right of all shareholders to have equal voting rights.

Mr. Chairman, I have found the investment banking community receptive and willing to help Congress act on takeover reform legislation. But, unfortunately, others who claim to speak for the business community have been less forthcoming. They want legislation to shut down the bidder but want no restraints on practices which shelter entrenched management. Congress should not shut down the bidder, Mr. Chairman, nor should it shelter the manager. Congress should not tilt the takeover playing field one way or the other. It should only ensure that it is level and fair.

You and I have discussed the importance of passing a bill that is balanced and neutral. Mr. Chairman, your bill is such a bill—almost.

While I commend you for the progress you have made, the playing field is not yet balanced. Let me now turn to specifics.

I wholeheartedly endorse your proposals to improve the tender offer process and the disclosures bidders have to make. These changes, such as lowering the section 13(d) disclosure threshold, closing the 10-day window, lengthening the tender offer waiting period, and stopping creeping tender offers will ensure fair disclosure and fair treatment of shareholders.

It's on the management side, as I've said, that progress is still needed. In its present form, S. 1323 does not achieve the neutrality between bidders and targets that the Congress sought when it enacted the Williams Act. Aside from its ban on greenmail without shareholder approval, an important reform which I totally support, S. 1323 does not sufficiently limit management's discretion to employ antitakeover measures that may or may not be in the best interests of the shareholders.

The bill purports to restrict the adoption of golden parachute agreements and poison pills. As a matter of fact, it does address itself specifically to that issue. And those are devices which protect the interests of management at shareholders' expense. But I am concerned about the fact that the way it's drafted it will not achieve its purpose.

These restrictions limit golden parachutes and poison pills adopted during a takeover contest but not ones adopted beforehand. With all due respect, Mr. Chairman—and you know that I have tremendous respect for you and the members of this committee—this part of the bill creates a loophole large enough for the chief executives of each of the Fortune 500 companies to walk through side by side.

Currently, managements customarily are adopting poison pills and golden parachutes before becoming targets. I have been reliably informed by the people most knowledgeable in this area that companies have been moving down this path at an amazingly fast pace. Unless these actions also are prohibited, the intent of your golden parachute and poison pill restrictions will be defeated and I think that would be sad.

Mr. Chairman, I recommend that these provisions be amended to bar golden parachutes and poison pills that are adopted at any point without shareholder approval. Whether they are adopted during or in anticipation of a takeover contest is not the issue. They don't make good sense. They are not good for the business community and they are not good for the shareholders and they are not good for the employees and they are unfair.

Given the frequency with which such actions have been and are still being taken, I myself would make these prohibitions retroactive and I am frank to say to you, Mr. Chairman, as one who practiced law for a good many years, I have no doubt in my mind that it could be drafted and be totally constitutional.

To make S. 1323 a truly balanced bill, I also would encourage the committee to remedy other management abuses, such as selling the company's crown jewels to deter a takeover or issuing additional stock designed to dilute the voting rights of existing shares.

My bill, S. 678, would prohibit management from making such structural changes without shareholder approval to defeat a takeover attempt.

Finally, let me mention the issue of protecting pension assets from abuses. Despite laws that require pension assets to be managed exclusively for the benefit of participants, pension plans are being manipulated to help finance corporate acquisitions as well as defensive tactics.

Workers and retirees can be innocent victims in these takeover battles. I support the provisions of S. 1323 which are intended to stop this abuse. However, I believe the current language could be strengthened somewhat. It should be made clear, for example, that companies would be prohibited not only from using pension fund assets to repay takeover-incurred debt, but also from using the pension funds as collateral to borrow money for the very same purpose.

Earlier this year, the Subcommittee on Labor, which I chair, conducted hearings on this and related issues and I would like the opportunity to work with you on improving your provisions in this area.

Mr. Chairman, these additional limitations on management and pension fund abuses, coupled with your proposals incorporated in S. 1323, will represent a critically needed reform of the takeover process. I am so pleased that you have moved this far in the process in the legislation. I hope that you will continue the effort with dispatch because I am concerned that 6 months from now nobody will really have much interest in doing anything about it legislatively, and that just happens to be the reality of the world in which we live.

I want to commend you for the progress you have made to date. With a few of of the changes I've suggested, and which I hope you see fit to include, I think that this would be a Magna Carta for shareholders in this country.

The CHAIRMAN. Thank you very much, Senator Metzenbaum. As I've said many times, you certainly would have to be right up there among the first, probably the first most valuable Senator we have in the U.S. Senate. I've said that for many years for many reasons.

Senator METZENBAUM. Thank you, sir.

The CHAIRMAN. Now you're especially expert in this area. You have concentrated on the antitrust field. That's in your committee, the Judiciary Committee.

Is it true that 9 out of the 10 biggest mergers in the history of our country took place last year?

Senator METZENBAUM. That's correct.

The CHAIRMAN. And what was the response of the administration in terms of providing resources to fight antitrust mergers?

Senator METZENBAUM. The administration was standing on the sidelines applauding. This administration seems to think that bigger is better. This administration has been totally indifferent to the whole issue of antitrust law enforcement.

The **Chairman**. Was there not actually a cut in antitrust funds available or spent?

Senator **Metzenbaum**. There was an effort to cut 100 antitrust employees, but I'm happy to tell you that the Judiciary Committee, without any objection from any member of the committee, totally rejected that proposal.

The **Chairman**. But the number of antitrust cases brought by the administration declined, did it not?

Senator **Metzenbaum**. It has declined overwhelmingly. I don't have the figures before me.

The **Chairman**. In spite of the fact we had 9 out of the 10 biggest mergers in the history of our country taking place?

Senator **Metzenbaum**. That is correct.

The **Chairman**. Now our bill emphasizes disclosure. We feel that's the core correction to this situation, so all shareholders will have equal access to the facts. This limits insider trading and that's one of the elements that has made takeovers unfair. I appreciate your recommendations on the poison pill and golden parachute and will certainly give them every consideration. You suggest that we simply not confine it to the takeover period but that we provide, to the extent that we can, that they be prohibited, period.

I have heard nothing so far on the adverse effects of takeovers on debt. Now we know, for example, that Unocal increased its debt from $1.2 billion to $5.2 billion. We know that Goodyear Tire and Rubber had to increase its debt to fight off Goldsmith's takeover attempt. This has happened again and again and again.

Isn't it adverse and perverse for our corporations to be pushed into debt? Doesn't that make them more vulnerable come another recession?

Senator **Metzenbaum**. Well, I think there's no question about it. Too many corporations are incurring too much debt. I think all you have to have is a—you don't have to have a depression, you just need a little recession, and I think many of them are going to have difficulty in starting to meet their obligations. I've heard about one large drug chain here in Washington recently—I think they maybe straightened out their problem—but as I read in the paper, they had done a leveraged buyout and then they were having difficulty making their payment on their debt. I think that they will be just one among many that have difficulties along that line.

The **Chairman**. Now you point out that our bill does not sufficiently curb corporate defensive abuses, but almost all of these abuses are a response to the coercive and manipulative tactics of the raider.

If we can curb these raiders' tactics, won't most of these corporate defense abuses diminish?

Senator **Metzenbaum**. Mr. Chairman, I just would take issue with you on that description. I don't believe that every raider's effort is coercive and manipulative. I think that it's totally part of the free enterprise system.

The **Chairman**. Well, I don't say so either. I would agree with you. Some are and some aren't.

Senator **Metzenbaum**. That's right.

The CHAIRMAN. We want to curb those that are.

Senator METZENBAUM. And I would say to you that doing some of the things that you're doing will outlaw the opportunity of some of the raiders who operate just for the purpose of getting greenmail. But having said that, I think we must be careful that we not just lock in entrenched management.

I came from the corporate world. I was the chairman of the board of a company on the New York Stock Exchange, one on the American Stock Exchange, one on the over-the-counter market, and I think too often management is more concerned about itself than it is about its shareholders.

All I urge upon you is that we push hard for this balanced playing field and I would hope that the U.S. Chamber, the NAM, and the Business Roundtable would join in recognizing the need to have such a balanced playing field.

The CHAIRMAN. And I especially want to thank you for your help and your recommendations and the work that you've done in protecting pension funds. You are the leader in the ERISA area and the recommendations that you make are welcome and we will certainly give them every consideration. We wanted to do what we could to see that they are not abused in takeover cases and we will try to perfect it to follow your advice.

Senator METZENBAUM. What you did is great. I just think we can go just a step further on that score, just so that the money is not borrowed against. You've prohibited the use of the money. I just want to make sure they don't use the money to borrow against.

The CHAIRMAN. Senator Armstrong.

Senator ARMSTRONG. Mr. Chairman, I want to join you in congratulating our colleague on his presentation and may I say to Senator Metzenbaum that I especially appreciate the observations which you have made about the motives and the insights that you have given us about people who are corporate managers. I think your points about golden parachutes and poison pills and greenmail are correct and the need for the balanced bill are right on target.

I'm not sure where that balance point is, but I must say that I find myself more attracted to the notions that you have expressed than those that are expressed in the pending legislation. The bill before us, in my opinion, is not a balanced piece of legislation. So I thank you for that.

Senator METZENBAUM. Thank you, Senator.

Senator ARMSTRONG. Without wanting to be a wet blanket, however, I want to express my utmost skepticism that the organizations that you mentioned in closing—the Chamber of Commerce, the NAM, and the Business Roundtable—will join in pushing for such a balanced bill.

I hope events prove me wrong, but my expectation is that they are going to get behind the chairman's bill, which is an incumbents' protection act, and if they do otherwise I would think it would be an act of great statesmanship, but it's not something which I would for a moment expect nor would I be disappointed if they don't because one is just asking these trade associations to do something which would be contrary to the innermost thoughts and directions and urgings of the people who pay the bills. So they are not going to do it for exactly the same reason that you pointed out yourself with respect to the motives of corporate managers.

May I ask Mr. Cox—Mr. Chairman, I'm sorry not to have been here when you testified. I have read through your statement. But there was a horrible traffic jam this morning which delayed my arrival and I'm just sorry I couldn't be here.

In reading your statement, which I found most interesting and worthwhile, I couldn't tell the answer to the most important question which is, would you vote for this bill if you were going to vote on it this morning?

Mr. Cox. Well, we did not formulate our position as an up or down, an oppose or support. We went through the bills and tried to give the benefit of our expertise on the different aspects.

But I would say that overall I believe that on balance there are more objectionable aspects than acceptable. So, personally, if I were voting this morning, I would vote against.

Senator **Armstrong**. Thank you.

Dr. Sprinkel, I also offer the same apology to you and I have read your statement as well and I particularly wanted to express my admiration for the point you make about the social significance of the market in corporate securities.

EXCESSIVE DEBT

I would like to ask if you would care to comment on the debt issue. There is a sort of a premise I guess that it's a bad thing for corporations to issue debt. Would you comment on it, No. 1? And if you share that general feeling that debt or some level of excessive debt is hurtful, would you tell us whether or not we have reached that level of excessive debt in your opinion? And if so, whether or not that is largely as a result of corporate governance issues or takeover issues or whether in fact it may be more deeply rooted in tax policy?

Mr. **Sprinkel**. Senator Armstrong, I share your concern about excessive debt. Thirty-some-odd years ago, I wrote a thesis on that subject and everyone was concerned then. The debt has increased enormously, both public and private, and we are still concerned. Why would you be concerned?

Primarily, in my opinion, not because it would cause a depression or a serious recession; but if one were to happen, for whatever reason, it tends to make the economy a little more vulnerable. And I might add that in my opinion it's not primarily the merger developments that have caused the debt.

When I was in Treasury a few years ago and at the instruction of the President, we looked at the total tax package. One of the areas that I personally wanted changed very much was the tax incentive to finance with debt instead of equity. And in Treasury I, we had a proposal that would significantly reduce the incentive to finance by debt for the very reasons that it makes the economy a little more vulnerable to downturn. It didn't survive. We could not get sufficient support either in the U.S. Congress or in the business community and it's not fair.

Now the fact that the corporate tax rate came down somewhat—and therefore you can't deduct quite as much interest as before, you don't get quite as much tax benefit as before—that helps a little bit. But you do not create the incentive to finance by equity by making that interest partially deductible.

So the bottom line is, I am concerned. I tried to do something about it unsuccessfully. I think it's the tax system that mostly encourages it, not primarily a result of mergers.

Senator **ARMSTRONG**. Mr. Chairman, could I ask your indulgence for about 30 seconds more with Chairman Sprinkel?

The **CHAIRMAN**. Certainly.

Senator **ARMSTRONG**. Could you just quantify that? I personally am convinced that your analysis is correct, that to whatever extent debt is an excessive problem, it has been fostered almost exclusively by tax considerations rather than by takeover considerations.

But could you quantify it? Is the tax component of this business policy decision 50 percent of the incentive, 60 percent, 80, 90, 100? In other words, are we dealing with a problem that's almost exclusively tax-related, or to what extent is the takeover part of it a consideration?

Mr. **SPRINKEL**. I could not precisely answer that question. My intuition tells me that most of the incentive is due to the tax system. I would be glad to pose that question to my people when I get back and see if we can be a little more precise than that because I just can't answer it.

Senator **ARMSTRONG**. I thank you and I thank the chair.

The **CHAIRMAN**. Senator Shelby.

Senator **SHELBY**. I'd like to ask Dr. Sprinkel this. You mentioned the lack of production of new jobs in Western Europe and so forth.

Mr. **SPRINKEL**. Yes, sir.

Senator **SHELBY**. Is that basically because there is lack of competition in the marketplace there?

Mr. **SPRINKEL**. [Nods head.]

Senator **SHELBY**. There are a lot of managers of large corporations that are fat and lazy that have not had any challenge in the marketplace?

Mr. **SPRINKEL**. Yes, sir. Basically, that's exactly the reason and it's not just particular markets. It's in capital markets. It's in labor markets. It's in financial markets. In many cases, there are severe restraints on the amount of competition.

For example, it's very difficult and very costly in Western Europe to create a new job, and the incentives exist to substitute capital for labor. One of the reasons they are reluctant to create new jobs in many of the countries is that, if later on they get a slowdown in the economy and they want to lay people off temporarily, they can't do it except by going through very costly procedures, getting government approval at various layers, and paying substantial severence contracts. So they just don't create jobs in the first place. That happens to be true, but in most of the other areas the degree of rigidity in markets is much greater than here.

I'm Chairman of the Economic Policy Committee of OECD and coming out of our committee this year was what I thought was an excellent study of structural inhibitions to growth in Western Europe and a lot of specifics about individual markets.

Now those governments recognize the problem, but it's difficult politically to change.

Senator SHELBY. Dr. Sprinkel, has the shareholders basically in America benefited from a lot of competition and takeovers of various companies?

Mr. SPRINKEL. Well, we reviewed the literature as widely as we could. There's a lot of it. And, in my opinion, the overwhelming evidence says, yes, the stockholders have benefited on average, most of the time, and that if we make it more difficult for these mergers to occur shareholders will benefit less and the stock price will be less. But the overriding thing is not the wealth of the stockholders; it's the efficiency of the U.S. economy. And that is consistent with the evidence which I mentioned.

Senator SHELBY. What will happen basically if we pass legislation like this, a lot of the industries in the smokestack area that are troubled, that are having trouble competing globally and so forth, will this cause them to be less competitive down the road with old management and so forth?

Mr. SPRINKEL. It might. You cannot be certain about the future ever. But such legislation would tend, I would suspect, to decrease the incentive to shift resources into areas that are growing and out of areas where markets no longer exist in a profitable way.

Now the reason some States obviously object is that they can see the short-run job loss, but they cannot see the long-run job gain as well as a benefit. But, yes, I think it would tend to slow the shift of resources out of less profitable into more profitable industries and, therefore, I could not consider that a desirable move.

DO WE NEED LEGISLATION?

Senator SHELBY. Dr. Sprinkel, do we need this legislation at all, considering the job that the SEC has done—at least seemingly done—and also what the Justice Department particularly the U.S. attorney in New York has done regarding a lot of the insider trading problems?

Mr. SPRINKEL. I have been very favorably impressed by the job that the SEC has done. The fact that many prosecutions have been brought and proven certainly indicates their diligence. I do not believe this legislation is desirable and if I have to——

Senator SHELBY. Do you believe it's going to create any jobs in America?

Mr. SPRINKEL. No.

Senator SHELBY. It's going to do quite the opposite?

Mr. SPRINKEL. I think it will do exactly the opposite and that's why, if I were forced to vote for or against, despite my friendship with Senator Proxmire, I would have to vote against.

Senator SHELBY. Do you believe a lot of people supporting the chamber of commerce and the National Association of Manufacturers will be for this because it's self-interest to perpetuate themselves and management, or would you rather not say?

Mr. SPRINKEL. I would rather not say, but they tend to work in what they perceive to be their own interest.

Senator SHELBY. Rather than the stockholders' interest?

Mr. SPRINKEL. That's correct, and not completely and not for all people. But I am more interested in the broader than in the narrower.

Senator **Shelby**. Thank you. My time has expired.

The **Chairman**. Thank you, Senator Shelby.

Senator Bond.

Senator **Bond**. Thank you, Mr. Chairman.

I want to commend our distinguished colleague from Ohio for his very cogent comments about our role in not shutting down the bidding for corporate control and assuring that the playing field is an even one. I think that is an excellent principle and I hope that we will be able to follow that in deliberating on this measure.

I, just for my own edification, if you don't mind, Mr. Chairman, I would like Dr. Sprinkel's comments, any views he might want to share with us on the discussions about the application of the antitrust laws to these mergers and what philosophy the administration has followed generally with respect to these large mergers.

ANTITRUST LAWS AND MERGERS

Mr. **Sprinkel**. Yes, sir. As you know, I'm not a lawyer. I'm an economist. But, fortunately, in the Antitrust Division, we have a peculiar breed of people that frequently melds both economics and law, which I find is a very useful melding. In essence, what is my understanding is that we look very carefully to see if there is any evidence that a merger decreases the competition in the market and therefore makes it possible for companies to reduce output, raise prices, and thereby raise costs to the American consumer. And in those cases where we believe that occurs, action has been taken.

The mere fact that a company gets larger as a result of merger, if it does not in fact exert monopoly influence, we would not oppose. But I would prefer you ask those questions of the persons at the Justice Department who are the experts rather than me. I'm certainly not a lawyer.

Senator **Bond**. As an economist, you don't see a failure to provide sufficient resources to the Department of Justice antitrust efforts, or are you saying that based on an economic analysis we have enough lawyers over there?

Mr. **Sprinkel**. I would have to let Attorney General Ed Meese make that decision, not me.

Senator **Bond**. Let me ask on another subject, in your testimony, you indicated the administration's opposition to limiting State laws affecting takeovers. We have heard a discussion from the distinguished Senator from Colorado and the distinguished Senator from Alabama about the pressures that are exerted very often by entrenched managements and their organizations to stop takeovers. Protecting management seems to be something that is near and dear to their hearts.

Even if a competition developed, in light of the recent Supreme Court case, for all States to adopt very stringent antitakeover measures which would be attractive to the management which, based on my experience, makes the decisions as to the States and locations of activity—even if we spiraled out into a competition where each State outbid each other in protecting entrenched management, thereby destroying the national market for corporate control, the administration still feels that we should leave corporate governance to the States?

Mr. SPRINKEL. I was hoping no one would ask that question because it is a very sticky one, as you well know.

Senator BOND. As a former State chief executive, I feel very strongly about State prerogatives, but in this area I'm worried about the balance and I'd like your analysis.

Mr. SPRINKEL. Well, I have thought about it. The Indiana case, *Dynamics Corporation of America* v. *CTS Corporation,* is the one to which I presume you are referring where, in essence, the ability of the acquiring stockholder to vote his shares was severely limited, therefore making it very difficult for the takeover to happen and thereby tending to protect the vested interests, whatever they might be—be they the workers, be they the management or whatever.

As you know, the Solicitor General argued in that case—and again, I'm not a lawyer—that Federal legislation should not overrule the Indiana law in the sense that the issue should be handled on the whole by the States, not by preemptive power of the Federal law, and the court agreed with that. The Solicitor General also argued that this was an unfortunate case and should be declared unconstitutional because it interfered with interstate commerce, and the court did not agree with that.

Now there was great concern that Delaware would move down that road. They did not. They have deferred it partly for the reason that you mentioned, but partly because they had some real concerns about whether this was a sensible approach.

I have great confidence that this competition in the States will be such that most of them won't march in Indiana's direction. Let me tell you why.

The holders of shares of companies that are headquartered in Indiana will have lower prices than they would have had if it hadn't been for that law. Therefore, I would expect that competition among States would encourage movement of corporate headquarters to those States where the stockholders benefit the most.

So I am very doubtful that there will be this race toward the minimum. I think it will be a race to find the location which will lead to the best deal for the stockholders and, incidentally, for the rest of the country. So I still come down that I wouldn't want to overrule it, but it's a bothersome thing.

Senator BOND. Mr. Chairman, with your permission, 30 seconds to comment on that?

Mr. Sprinkel, obviously I'm not an economist. I admit to being a lawyer. I question your assessment that the shareholder prices would force corporate relocations out of States that have Indiana laws. I think that you are likely to see a proliferation of Indiana-type laws for the reasons discussed earlier. Perhaps on another occasion, if that comes true, we will have the opportunity to discuss again your views on whether State law is necessary.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Sanford.

Senator SANFORD. Thank you very much. I have an opening statement that I would like to enter in the record.

The CHAIRMAN. Without objection, it will be printed in full at the start of the hearing.

Senator SANFORD. All right.

It seems to me that we are talking about a fairly small segment of corporate mergers when we talk about abusive hostile takeovers. There is nothing in the world wrong with mergers and acquisitions where both parties freely enter into the agreement. There is nothing wrong with the concept of changing management, as we did for years, with proxy fights. There is nothing wrong with the concept of going into the market and buying control of management if you're not satisfied with it.

But what we are talking about now is a relatively new scheme—and scheme is probably a kind word for it—where about a dozen takeover artists roam the country looking for opportunities, taking advantage of situations without any considerable financial at risk of their own, and using, so-called bridge financing so that they can grab companies and hock the assets to pay down their junk bonds.

It's that kind of abuse that we are talking about, not mergers, not acquisitions.

Mr. Sprinkel, you said the available evidence is that unsolicited transactions improve efficiency and create new wealth. I do not believe that an examination of all of the available evidence leads to that conclusion. I would like to know whether you have examined the studies by Lowenstein of Columbia or Scherer of Swarthmore? Most of the evidence in those studies suggest that your conclusions are not the case, you don't create wealth when you put money into the hands of the shareholders. Where did the wealth come from? It was drained from the strength of the corporation. The creation of wealth is an illusion that in fact greatly diminishes the strength of the corporation to serve its community purpose.

I just wonder if you could supply us with the available evidence?

Mr. SPRINKEL. I'll be very pleased to do so. In the testimony which I submitted on page 12, there is a long list of cited evidence, most of it——

Senator SANFORD. I scanned all of that and I quoted specifically from page 4 because I don't think the available evidence is all that substantial.

MOTIVATION FOR HOSTILE TAKEOVERS

Now, let me ask you, what do you think motivates the people who make tender offers and who take advantage of this scheme of hostile takeovers? Do you think they are roaming around the country trying to improve corporate management?

Mr. SPRINKEL. I certainly do not believe their objective is to improve the efficiency of the U.S. economy. That is not their objective, but that is the result. That is, the evidence, study after study, indicates that permitting hostile takeovers in fact raises stockholder wealth. It brings about painful shifts, changes in management technique, sometimes reallocation of capital that otherwise might well not have occurred.

Senator SANFORD. Why should such changes have occurred? Are you suggesting that every corporation in America is badly run and ought to be subject to takeover?

Mr. **Sprinkel**. No, sir. They ought to be subject, but they certainly won't be taken over. I mean, most of them are very well run.

Senator **Sanford**. Does the quality of management have anything to do with the decision to take it over?

Mr. **Sprinkel**. It surely does.

Senator **Sanford**. For example?

Mr. **Sprinkel**. Because if the managers are doing well and if they promise to do better in the future, it will be very difficult to take the corporation over.

Senator **Sanford**. The better they are doing, the more likely a target they are. The better surpluses they have got built up, the better pension fund they have got built up, both of which indicate good management—the better those assets are, the more likely a target. So it puts a penalty on good management.

Mr. **Sprinkel**. You forget, of course, that the better the management is, the higher will be the price of the stock—and the potential to raise the stock price is the incentive to try to acquire a company.

Senator **Sanford**. That, too, is not realistic because there's hardly a corporation that at times is not undervalued because of the way the stock market works. I would daresay that a great many successful corporations could be broken up, liquidated, the money divided up among the stockholders, and the stockholders would gain over the market price. But that's not necessarily the kind of policy that you are advocating, is it?

Mr. **Sprinkel**. No, sir. I am advocating a high degree of competition which, in my opinion, will be a very good restraint on the kinds of abuses that some have imagined are occurring.

Senator **Sanford**. But what has that got to do with takeovers?

Mr. **Sprinkel**. It has a great deal to do with takeovers. If you insulate present management and prevent individuals from making hostile takeovers by making the process very costly, then this competition won't happen. You will stop the takeovers, but it will be to the detriment of the economy.

Senator **Sanford**. Well, I hate to say it, and I will read your testimony more carefully, but that's the most ridiculous statement I've ever heard in this hearing room.

The **Chairman**. Senator Sasser.

Senator **Sasser**. Thank you, Mr. Chairman.

Mr. Chairman, I have an opening statement which I would ask unanimous consent be incorporated in the record as if read.

The **Chairman**. It will be placed in full in the record at the beginning of the hearing.

Senator **Sasser**. Dr. Sprinkel, according to Business Week, corporate debt has increased by $384 billion over the last 2 years and, at the same time, about $200 billion worth of corporate equity has vanished.

Now Alan Greenspan testified before this committee in January that takeover and merger activity had caused—I'm quoting him—"a very substantial part of this." Greenspan went on to say, "The huge increase in corporate debt has essentially offset the benefits that could have occurred from the dramatic decline in interest rates over the last 5 years."

Now here we have a situation where the probable next chairman of the Federal Reserve is saying that takeovers have saddled our corporations with debt as well as caused us to miss a very significant productive opportunity that came with the lower interest rates.

Of course, this productive opportunity came at the very time when American business and American corporations were having a very difficult time competing not just domestically but also internationally.

How would you respond to Dr. Greenspan's observations?

DEBT FINANCING VERSUS EQUITY FINANCING

Mr. SPRINKEL. Well, I have not seen the total statement and, therefore, I would have to see it before I respond. But I would return to observations that I made previously that there are major incentives for corporations to use debt financing versus equity financing. Over time, I would like to see those incentives reduced. We were not able to get it into the last tax reform bill. I hope we can get it into the next one because I think it does make the economy somewhat more vulnerable.

But I think it's not too sensible to pick out particular developments. Suppose a company wants to expand and build a larger plant and more efficient capital. They are likely to use debt. But, in turn, I would not want to make it impossible for them to expand and to acquire more efficient capital with which they can produce profits.

So I think we should get back to the source of the cause, not the particular way in which that debt financing happens to occur.

Senator SASSER. Well, you're not telling this committee that the primary reason corporations are financing out of equity is because of the tax laws? It appears to me, given the economic environment that corporations are operating in now, woe betide the corporation that's sitting there sitting on top of a great deal of equity. You're just a big fat target just waiting to be put in play. Isn't that a fair statement?

Mr. SPRINKEL. I think that the major reason for the rapid growth in corporate debt over the years has been the tax incentive to use debt rather than equity financing. Now that isn't the only factor. The fact that until fairly recently equity prices were relatively low was another reason why corporations eschewed issuing equity. Now that has picked up some of late, and I would expect that to help.

Senator SASSER. Well, now Mr. Greenspan also testified that he knew of a number of corporations which he had been associated with that had been subject to takeovers that were "run far better than the average American corporation."

Now that does not coincide with your view or, I might add, even Secretary Brock's view, that only poorly run and inefficient companies are taken over.

The question is, how efficient are these companies afterward when they are saddled with debt? We've seen that happen in my State with the Goodyear Corp. as they fought off the takeover folks and after they got through all they had left was a lot of debt and substantial number of unemployed workers but essentially the same structure that they had before, the same means of production they had before except it was greatly in debt.

Mr. SPRINKEL. There is no evidence, in my opinion, that this particular technique adds to stockholder wealth. In fact, there is evidence to the contrary. that the stockholders suffer. And, therefore, this may be something that regulatory authorities should look at. I would prefer that it's done through either the stockholders or through the States rather than by the Federal Government. They are much closer to the action.

Senator SASSER. Well, I would just end by saying this. With these large corporations, many of them multinational corporations, there are those who have an interest in these corporations other than stockholders. In other words, the communities have an interest. The employees have an interest. The pensioners have an interest. Indeed, the country has an interest in the health and vitality and competitiveness of these major corporations which do control by and large the means of production in this country and determine how effectively we are going to compete and how effectively our economy is going to run.

So this committee is now about the business of trying to fashion a structure that will produce not just for the corporations and not just for the stockholders, but will also protect the innocent bystanders, and that includes those others who have a vested interest in the prosperity of the corporation.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Sasser.

Before you gentlemen leave, I just want to make an observation. That is, I hope you will take a look at the studies referred to by Senator Sanford. Senator Sanford referred to a study by Dr. Lowenstein of Columbia University of several thousand corporations. In fact, he studied every merger that took place over several years. He found that the return on equity of the corporations taken over was 16 percent compared to the average return on equity for all stocks of 12 percent. In other words, they were more profitable. So Senator Sanford seems to be correct on the basis of that study.

Dr. Scherer of Swarthmore made a study of what happens to productive facilities when they are merged with another corporation. He found that there is very little change in the first years. He found that after several years their productivity declines. It does not improve the economy.

So I suggest that you might consider that evidence when you make your analysis of the effect of corporate mergers.

Senator SANFORD. Mr. Chairman, may I read one paragraph into the record and also for the benefit of Mr. Sprinkel as he proceeds with his consideration?

This refers to an article by Professor Coffey and I read it directly.

> Coffey also cites a 1981 Touche-Ross and Co. survey in which corporate directors were asked to rate specifics of target companies that made them attractive. It found that "excellent management" was listed as an attraction by at least 98 percent, while the vast majority of responses denied that the perceived inefficiency of the target made it an attractive takeover prospect.

I think this statement echoes the point I made earlier that those initiating corporate takeovers aren't trying to improve ineffective corporate management.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Before Mr. Sprinkel leaves, I'd like to ask for some follow-up information. I gather as a thesis of your position that you believe that this is not a Federal responsibility but rather should be at the State or corporate level.

Mr. SPRINKEL. Yes, sir.

Senator GRAHAM. I would like to get some data as to what is happening at the State and corporate level that would indicate a responsiveness to the concerns which led to the introduction of this legislation.

The CHAIRMAN. We would appreciate that, Dr. Sprinkel.

Mr. SPRINKEL. Yes, sir. We will do that.

The CHAIRMAN. Senator Riegle just has one question and then we want to go on as quickly as we can to the next panel.

Senator RIEGLE. First, I'm wondering if Commissioner Cox has been here over the weekend because when I left last week he was seated there and I come back today and you're still there.

Mr. Cox. I wonder if I could have a chair with my name on it.

Senator RIEGLE. Well, we may do that. It depends on your answer to this question. [Laughter.]

ABUSES AS TO HOSTILE TAKEOVERS

I would like to ask each of you what abuses you think have been going on that concern you the most on either side with respect to hostile takeovers, either the bidders' side or the corporate side? What do you see in the way of practices that would give you some considerable concern?

Mr. Cox. Well, I would say that, as we have argued for quite some time, we believe in prompt disclosure of substantial share ownership in corporations; the decision has been made that that should be disclosed at the 5 percent level. Yet purchasers have 10 days following achieving that in which to disclose it. We think it should be disclosed sooner. If the law says to disclose it at 5 percent, you should get it disclosed there.

That's why we suggest requiring a standstill once an acquirer hits 5 percent until it is disclosed, until the 13(d) statement is filed, and then the person would be free to proceed with appropriate amendments as the acquirer hit higher levels.

Senator RIEGLE. So you would see acquisitions above 5 percent in the 10-day period as an abuse?

Mr. Cox. Yes. I think the decision—to me, it's fairly clear that 13(d)—the idea is you disclose when you hit 5 percent. And the fact that additional time was put in there I think was an artifact that might have been taken from elsewhere.

Senator RIEGLE. I'm with you. What else? I'm just sensitive to the time because I want to get Mr. Sprinkel's comments, too.

Mr. Cox. Well, one other aspect of the testimony is the concern with greenmail. Now while the Commission understands the concern with it, we really don't believe that it's consistent with the Federal securities laws to step into this corporate governance area and say it's prohibited. Rather, we think it could be addressed through disclosure either prior to the purchase or immediately following it. Either way, but we think that that would be a good approach.

Senator RIEGLE. You will find some difference of opinion. A lot of us don't see greenmail as much different than someone with a gun on a sidewalk that says "Hand over your wallet."

Mr. Cox. That's why I understand the concern of this committee, and we share that concern at the Commission. It's just that I think that something that is so much an internal matter of the corporation could be handled by requiring it to be disclosed before the purchase from the holder was made so that shareholders could take appropriate action and challenge that purchase. I think that that is perfectly consistent with the Federal securities laws as they have been set up.

Senator RIEGLE. Mr. Sprinkel, what are the abuses that you see that concern you, if any?

Mr. SPRINKEL. Well, there are some that I watch carefully and think about. There are none that I'm aware of that need to be corrected at the Federal level, as I've indicated previously. I would either prefer to see the stockholder take the action—they are the ones that will be impacted—or, if not there, at the State.

Greenmail tends to bug me a little bit because it looks as if you're paying off the raider to protect the management at the expense of the stockholders. Yet, when you look at the evidence, there's not much evidence that the practice adversely affects stockholder wealth. So if it's a problem, it doesn't seem to be a big one.

Golden parachutes, again, looks like a device that we could do without, until you start thinking about it a while. For example, it turns out that many companies in trying to attract good management frequently have to have a provision whereby if someone tries to push the new management out because of perhaps previous mismanagement they have some kind of a contract for severance. I don't feel it's very useful policy to say that's illegal, even though in certain circumstances it might appear to be unfair.

On some of the poison pill areas, again, I am concerned about corporate leverage and excessive debt, as I expressed previously in the testimony. But if this is a problem, it seems to me it is not a Federal problem. It's a State problem.

Senator RIEGLE. I guess I'm hearing you say that basically there really isn't an abuse problem as you see it, regardless of which level of government it falls at. I don't sense any great concern on your part.

Mr. SPRINKEL. That's correct. And as I stated earlier, if I were asked to choose what I would do about this particular bill, I would vote against it.

Senator RIEGLE. All you've got to do is get elected to the Senate and you would get a chance to do that. [Laughter.]

The CHAIRMAN. We're anxious to get on to the next panel, but Senator Wirth has a quick question.

Senator WIRTH. Thank you very much, Mr. Chairman.

Mr. Cox, in this legislative proposal before us is a provision that requires any acquisition of a firm's stock beyond 15 percent must be by tender offer. You are familiar with that?

Mr. Cox. Yes.

Senator WIRTH. And your testimony opposes that provision, is that correct?

Mr. Cox. Yes.

Senator WIRTH. In 1980, I remember the SEC sent up to the Congress a proposal that said that anything beyond 10 percent ought to be done by a tender offer. So the SEC's position in 1980–81 was 10 percent was the threshold. Now you are opposing a 15-percent threshold. Can you tell us what's changed in the last 6 years?

Mr. COX. Well, certainly the Commission has changed. [Laughter.]

Senator WIRTH. I'm not sure, Mr. Chairman, that's really responsive. We're talking about the economic health of the country.

Mr. COX. Senator Wirth, I have an additional response.

Senator WIRTH. Good.

Mr. COX. The Commission position on that aspect is that a requirement to make acquisitions by tender offer beyond a level, like 10, 15, even 20 percent, would have a substantial impact on the securities markets outside of the tender offer area, that there are a lot of block positions held and traded that have nothing to do with tender offers that would be seriously hampered by such a requirement.

Senator WIRTH. Is that a fact that has changed since 1980–81? Is that a dramatic evolution in the market that's a lot different today than it was then?

Mr. COX. I suspect that holding of block positions is more important now than at that time, but I think that the change is perhaps realizing the impact that such a provision as included in those bills would have on the functioning of the securities markets. I really think it would be unwise.

Senator WIRTH. Well, Mr. Chairman, just for the purposes of the record, the Commission's position in 1980, the Commission at that point stated that such a provision of only 10 percent then—"such a provision would further the goal of providing all securities holders an equal opportunity to participate in the sale of controlling interest in public issuers," and you now think that such a provision would not protect shareholders; is that correct?

Mr. COX. I certainly do. I think it would be detrimental to shareholders.

Senator WIRTH. Just as a final note, we have a panel of State regulators coming right behind this, Mr. Cox, and I was wondering if you or Mr. Sprinkel might be interested in commenting on the provisions in the Proxmire-Riegle bill that affirms the role of the States. The purpose of that question is to focus on what some have said is a potential balkanization of the securities markets, that if we're going to have a national securities market we ought to have a national securities market, and that to allow ourselves to move on with potentially 50 different regulatory schemes is really dysfunctional in terms of the overall thrust of the national economy.

Maybe you both might like to comment briefly on that.

COMMENTS ON PROXMIRE-RIEGLE BILL

Mr. COX. Well, I think that the Commission opposes the provisions as they are stated in the bill, but I believe——

Senator WIRTH. Opposes what?

Mr. COX. Opposes the provision regarding State law.

Senator **Wirth**. I think that just affirms current State law, so the Commission is opposed to that?

Mr. **Cox**. No, no. I thought—it's unclear because it's unclear to us just what the provisions entail. In considering this, the Commission was of the idea that the implications of something like the CTS decision should be allowed to evolve. We're not really sure what they will be. Some have argued that such a decision would benefit the bidder for takeovers rather than the target.

So I think that provisions such as those in the Proxmire-Riegle bill and their implications are so unclear that, rather than affirming or denying that there should be such State law provisions, it's unwise to adopt such provisions at this time.

Senator **Wirth**. Mr. Sprinkel.

Mr. **Sprinkel**. When I saw the statement arguing that they respected the primacy of State law in the corporate governance area, I thought it was going to be a portion of the law that I would be very happy about, until I read further. Unless I misread it, section 12 purports to do that, but its actual effect, in my opinion, would be to preempt any State law regarding corporate governance that favored the interest of shareholders more than would the pro-management sections of S. 1323.

That is, if you want to get tighter, that's fine, States—go ahead, if you want to throw even more roadblocks into this merger process. But if in fact you want to ease up, then the Federal law prevails.

So I do not consider that particular section as giving primacy to the States, and I don't like that particular section.

Senator **Wirth**. Mr. Chairman, thank you very much.

The **Chairman**. Thank you very much.

Our next panel consists of Daniel Bell, president, North American Securities Administrators' Association, from North Carolina; Anthony Celebrezze, representing the National Association of Attorneys General, Columbus, OH; Jim Edgar, representing the National Association of Secretaries of State, from Illinois; and Richard Geltman, general counsel, National Governors' Association.

Gentlemen, we are happy to have you here and I hope we can proceed as rapidly as possible. We thank you for your patience and apologize for the delay. I think we will proceed in the alphabetical order which is listed here with Mr. Bell first.

Mr. Bell, go right ahead.

STATEMENT OF F. DANIEL BELL III, PRESIDENT, NORTH AMERICAN SECURITIES ADMINISTRATORS' ASSOCIATION

Mr. **Bell**. Thank you very much, Mr. Chairman.

The **Chairman**. Let me interrupt to say that each witness will have 10 minutes to give his presentation.

[The complete prepared statement of F. Daniel Bell III, follows:]

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[illegible]

Statement of F. Daniel Bell, III

President
North American Securities Administrators Association

before the

Committee on Banking
United States Senate

June 23, 1987

Mr. Chairman and Members of the Committee:

My name is Dan Bell. I am Securities Administrator for the State of North Carolina and President of the North American Securities Administrators Association (NASAA). NASAA is the association of the state and provincial securities administrators from the United States, Canada, Mexico and Puerto Rico, who administer and enforce securities laws in their jurisdictions. NASAA works to protect investors and to ensure that the securities markets operate with a minimum of abuse. I appreciate the opportunity to appear before you today.

Members of NASAA are located in all fifty states. We work with investors in every local securities market in the nation. From Fort Lauderdale to Salt Lake City and from Wall Street to Spokane, we see the real world of today's securities markets. For some time now, we've told Congress, the SEC, and our state legislatures that all is not well in America's capital markets.

Why?

First, because the budget of the SEC has failed to keep pace with the burgeoning markets. It is clear, despite what some may say, that the SEC cannot do more with less.

Second, because the range and diversity of investment instruments, as well as the number of Americans seeking investments has grown enormously, just as the deregulatory wave hit high tide.

Finally, because for too many market players today the expected benefits of violating the securities laws appear to outweigh the potential costs of getting caught.

Deregulation makes sense on some issues sometimes. But an uncritical deregulatory philosophy, so eagerly embraced by many public officials, brings us today to a need for serious reevaluation in the area of securities law and enforcement. Abuses in the takeover process and insider trading scandals now serve as fair warning: there are limits beyond which financial markets can be unregulated and still function efficiently, safely and fairly. When the cops are pulled off the beat, crime goes up.

Mr. Chairman, I commend you and all the cosponsors of S. 1323 for taking an important first step toward the restoration of marketplace integrity and investor protection. The time you, Committee members, and your staffs have expended on studying the problems and designing an appropriate legislative response is greatly appreciated. S. 1324, introduced by Senator Sanford, is

Mr. Chairman and Committee Members, reform of the tender offer process is critically needed, as are stepped up sanctions against inside traders. But we urge you to consider these issues within the broad context of concern about a marketplace system with serious flaws, and a great deal of fraud, which demands statutory protections and vigorous enforcement in the several states and nationally. Our recommendations which go beyond the tender offer reform issue, provide important components of a comprehensive strategy for federal and state cooperation that will close the gaps that have led to appalling abuses that threaten the integrity of the financial markets, the health of the economy, and the well-being of individual investors.

Thank you.

The CHAIRMAN. Thank you, Mr. Bell.

Attorney General Celebrezze.

STATEMENT OF ANTHONY J. CELEBREZZE, JR., ATTORNEY GENERAL OF THE STATE OF OHIO

Mr. CELEBREZZE. Mr. Chairman and members of the committee, I am Anthony Celebrezze, the Attorney General for the State of Ohio. I appreciate the opportunity to appear before you today and I ask that both my oral statement and the more detailed written comments which I have submitted be made a part of the official record.

The CHAIRMAN. Without objection, it will be made a part of the record.

Mr. CELEBREZZE. Mr. Chairman, I want to commend you and the other members who are cosponsors of this bill. You have recognized the fact that we as a society cannot afford the cost of the corporate takeover made solely in the name of so-called shareholder value, or of spinning the stock market.

We must consider the impact these takeovers have on the other important values which our country respects—our workers, their jobs and our communities. The callous disregard for those values by the raiders and the Wall Street bankers as they hunt their targets is the reason that this legislation is needed.

I am here today in three capacities. The first is as the Attorney General for Ohio, a State which has been the site of numerous and significant takeover battles in recent years.

The leadership of the State has responded by passing several important laws designed to protect against the hasty, gun-to-the-head decisionmaking which had characterized these deals.

I am also here on behalf of the National Association of Attorneys General, which has passed two resolutions outlining the Association's recommendations for changes in the law. These resolutions specifically detail our belief in the need for State regulation of tender offers and control share acquisitions, in keeping with Federal securities regulation. A copy of each of these resolutions is included in my written testimony.

Most importantly, however, I am here as an elected public official who hears the concerns of workers, community leaders, and business leaders about the control which the securities traders and corporate raiders now exert over the destiny of companies and the jobs they provide in our State.

Those business leaders now must spend their time, their energy, and their creativity developing strategies to defend against the hostile takeover attempt rather than on improving their product and building a business that's based on solid management principles.

The community leaders must face the loss of valuable contributors to the life of those communities, and the loss of jobs that that entails.

Those workers have to face the trauma and the financial hardship of losing their jobs, all in the name of maximizing shareholder wealth and spinning the stock market.

Mr. Chairman and members of the committee, one central point must not be ignored by the traders and the raiders who put together the billion dollar deals to rake in the million dollar fees and profits, or forgotten by the economists and their theories, or lost in all the buzz words that we hear in this arena, like poison pills, greenmail, and scorched earth, and putting a company into play. In the midst of all of this are real, live human beings who have a stake in the outcome of these types of deals also.

Businesses don't exist merely in the abstract, on stock tickers and balance sheets. Productive businesses are the heart and soul of Ohio's and every other State's economy. Companies are the employers of real people and the backbone of real cities and real towns across this country.

States have not only the right but also the governmental duty to ensure that their corporate citizens are treated fairly and that they behave fairly. A fever-pitched tender offer which robs a community of jobs for no reason but to satisfy some raider's notion of developing an "efficient" marketplace does a tremendous disservice to the employee, to the company, to the community, to the State, and even to our national economy.

Let me interject that I am fully aware that the vast majority of mergers are friendly ones and are negotiated transactions.

I am also aware that there are a significant number of hostile offers which are undertaken for legitimate business reasons of growth and development of a product or a market. I also agree that these deals would not and should not be harmed or even discouraged by legislative reform. What does need to be discouraged is the blindsiding, purely opportunistic offer which sends shock waves to the roots of a business' structure and a community's existence.

CONSEQUENCES OF HOSTILE TAKEOVERS

The consequences of hostile raids, even unsuccessful ones, can be severe and long term.

Some studies estimate that upward of 500,000 workers have been dislocated due to the wave of merger mania that has developed in recent years. Ohio's experience has mirrored this national trend.

Last year, Akron's Goodyear Tire and Rubber Co. was forced to defend itself against an unwanted takeover attempt by British financier Sir James Goldsmith. The defense was successful, but the costs are staggering. They had to close three plants. Thirty three apparently designed to limit hostile takeovers to those legitimately interested in taking over a company. While we have not had an opportunity to carefully review S. 1324, we suggest Congress also consider this legislative proposal.

However, I urge this Committee and the Congress to be ambitious, not minimalist, in seizing an historic moment to end widespread and chronic abuses of investors' rights and of the public interest.

Enhancing the resources and authority of the federal Securities and Exchange Commission (SEC) takes us only part of the way. For the regulatory system to work, states have a crucial statutory and regulatory role, requiring constant vigilance at the grass roots where the investing public is either protected or victimized. It is not surprising that in the five years since the 1982 Supreme Court decision [*Edgar v. MITE Corp*] invalidated many state takeover laws, merger mania has exploded on a scale not dreamed of by drafters of the original Williams Act. As this Committee knows, the takeover game in turn has helped spawn the insider trading abuses that have subverted the trading marketplace.

NASAA respectfully encourages this Committee to not simply enact reforms of the takeover process, but that in the interest of market integrity and investor protection, the scope of the bill be expanded to include issues of state/federal cooperation and oversight of self regulatory organizations as discussed in this testimony.

We recognize that sometimes tender offers may be economically useful and beneficial to shareholders and the nation. However, this is far from always the case. Increasingly, hostile offers too often are revealed to be cynical efforts not to take over companies but to make exorbitant profits at no matter what cost to others, including the shareholders and the companies themselves. Moreover, what may begin as an effort with a justifiable business purpose too often degenerates into a contest of raw power with the same costly consequences. Company executives, investment bankers, public relations professionals and lawyers battle one another in a contest of wills that inevitably pays little heed to public concerns. The impacts on investors and markets and the broad economic and social effects of such battles are frequently ignored.

Those who defend tender offer abuses and wink at insider trading often claim that, even if takeovers reduce competition, disrupt local economies, and waste scarce intellectual and financial resources, at least there are no "losers" in the securities markets. Unfortunately they are wrong. And, we are here today representing those who lose by tender offer abuses.

While insiders and Wall Street arbitrageurs may make some quick profits speculating on the prices of takeover targets, the average stockholder often ends up as just another victim. The manipulative nature of tender offers is more likely to rip off than to reward the average shareholder. The outcomes of these takeover battles are decided by a handful of executives behind closed doors, far away from the eyes of most investors. While ordinary investors are just so many foot soldiers in a war of dollars, the generals calling the shots are assured of six-and seven-figure incomes, pensions, stock benefits, and fees, regardless of whether they "win" or "lose."

Because state agencies are close to the shareholders and companies affected, we have a strong interest in preventing and resolving takeover-related abuses. The reforms that NASAA supports, from increased and more timely disclosure to affirmation of the state role in the regulatory process, are designed to protect the interests of the average shareholder by preserving his or her opportunity to make informed and prudent investment decisions. Such reforms strengthen the efficiency of our capital markets.

NEED FOR FEDERAL ACTION

Federal takeover law and practice are in shambles and have been for some time now. The recent scandals have revealed to the nation and this Congress how pervasive the problems are. The problems include inadequate disclosure mechanisms and unequal treatment of target company shareholders. This pernicious combination forces rush-to-judgment decisions by investors/shareholders that, in turn, subvert the integrity of the trading marketplace.

We support the tender offer reform provisions in S. 1323 because:

(1) The bill, as it pertains to tender offer reforms, is reasonably comprehensive in scope. A comprehensive approach is necessary because of the wide-ranging nature of the changes that are needed to remedy current problems;

(2) The bill's key provisions deal with the basic causes of the abusive practices this Committee has identified, and do not merely treat the symptoms of a takeover regime which is now out of control and in need of fundamental reform;

(3) The bill respects and advances, consistent with our federal system, the necessary roles of the states as well as the federal government by explicitly reaffirming the authority of the states to enact takeover legislation under their corporate governance statutes, so long as such

provisions do not conflict with federal law. However, we suggest that the state reaffirmation language be more precise; and

(4) Enactment of these provisions will not prohibit takeovers, but will establish a proper and fair process by which takeover attempts, whether friendly or hostile, may go forward. The bill will:

-- provide that acquisition of shares in anticipation of tender offers and the conduct of tender offers themselves will take place with timely and truthful disclosure;

-- ensure that all shareholders are treated equally with regard to an opportunity to participate in selling their shares when control of the corporation is sought;

-- prevent rush-to-judgment decision-making by providing adequate time for shareholders to evaluate and act upon a tender offer.

DISCLOSURE REFORMS

The federal government's full disclosure regulatory philosophy is often hailed as an effective mechanism for protecting investors without unduly burdening capital formation. It has been claimed that if all material information about an investment opportunity is fully and fairly disclosed to investors in a timely fashion, such investors will act rationally when choosing among investment opportunities. While the states remain skeptical that full disclosure alone provides adequate investor protection, we would urge that, so long as it remains the cornerstone of federal regulation, it should be improved to enhance its value to the investing public.

Under current takeover rules, investors have been victimized by an acquisition disclosure system that permits unconscionable delays in providing needed information to the trading marketplace and to the investing public regarding substantial share acquisitions. Current federal disclosure regulations have permitted misleading or incomplete disclosures by acquirors regarding such a critical issue as their intentions regarding control. Current regulations fail to accord adequate remedies for investors victimized by acquirors who file ownership information disclosures containing misrepresentations or material omissions.

S. 1323 effectively deals with the problems associated with delayed and misleading 13 D ownership information filings. Under this legislation, the prospects for full and timely disclosure would be enhanced with provisions that:

-- lower the acquisition disclosure threshold to 3 percent;

-- require disclosure on the next trading day after the threshold is reached;

-- preclude further acquisitions by the reporting person until the information is publicly disseminated; and

-- expand the required disclosure information to include identification of persons with whom the acquisitions were discussed; fees paid to lenders or others in connection with the stock purchase; identification of financing sources; and specification of whether the purpose of the acquisitions is for investment or control.

PRIVATE RIGHTS OF ACTION

The bill also provides a crucial enforcement tool which should have a very salutory deterrent effect: tougher sanctions against persons who make material misrepresentations or omissions in the disclosure filings. These sanctions include a private investor cause of action and prohibit an acquiror that has misrepresented its control intentions in prior 13 D filings from commencing a tender offer for six months. When market manipulation is committed through activity that should have been dislcosed, the law will now be on the side of those victimized by the manipulation. This legislation will allow private shareholders and others who may have suffered financial harm due to disclosure violations the right to sue.

The absence of full disclosure in the takeover process produces negative consequences that are compounded by the participation of market professionals in the process. Professional investor participants, individuals as well as departments of major brokerage firms, in conjunction with (and at times in collusion with) active corporate raiders, put corporations in play so that huge trading activity in a target company is generated, thereby putting effective or actual voting control in the hands of these same professionals. This activity, in effect establishing "markets for corporate control," provides fun and profit for a few, but may be riddled with insider trading activity and operates with impunity outside the effective coverage of the Williams Act. The integrity of the marketplace is certainly compromised in the way this game is played, as it ensures that raiders, abritrageurs and market professionals are winners while public investors are often the losers. If signed into law, the disclosure reform provisions and tougher sanctions against violators of the provisions contained in S. 1323 will repair much of the damage this game has inflicted on the integrity of the trading marketplace.

EQUAL TREATMENT OF SHAREHOLDERS

Numerous bidder acquisition techniques, not subject to Williams Act requirements, also victimize public investors. The result is unequal treatment of the target company shareholders (usually the small, public shareholders) who are either excluded or unfairly disadvantaged. Such non-equal treatment of shareholders occurs as a result of so-called "creeping tender offers," coercive "two-tier offers," and the "sweeping the street" technique. So long as these acquisition technique abuses are allowed to exist, and as new ones are developed to exploit loopholes in the Williams Act, the deck will remain stacked against public investors.

S. 1323 effectively deals with the equal treatment issue by providing that share acquisitions by any person beyond a specified threshold percentage must be pursuant to a public tender offer subject to the Williams Act and enabling all shareholders an equal opportunity to participate. The legislation establishes 15 percent as the threshold level. NASAA prefers a 10 percent threshold level. In many instances, 15 percent is tantamount to effective voting control of certain large corporations.

Defenders of the current system will no doubt argue that provisions of S. 1323, including affirmation of the state role, will slow down the tender offer process. To that, we say "Amen!" Abuses in the marketplace today exist not because the process is too difficult, but because it is too easy. Public investors are victimized by a rush-to-judgment procedure and mentality forced under the current 20 day minimum offering period. Furthermore, bidder developed techniques which exploit the 20 day minimum offering period, such as the front-end-loaded two-tier offer, advantage the bidders and help ensure the success of the takeover. Thus, under the current federal scheme, bidders can use the takeover equivalent of a "smash and grab" storefront burglary to acquire control of a target company "on the cheap" in as little as 20 business days -- before competing bids can develop and before the target corporation's management and shareholders know what hit them.

Bidder techniques certainly justify an extension of the minimum offering period. While S. 1323 provides an extension to 35 business days, our strongly held view is that the minimum offering period should be extended to at least 60 calendar days because: (1) the 20 day minimum period offers a tremendous timing advantage to a bidder, making a mockery of one of the principal

purposes of the Williams Act which is to provide neutrality and even-handedness between a bidder and a target company; and (2) providing for a longer minimum offering period will encourage competing bids which in turn will benefit shareholders. Empirical studies have shown that the longer the tender offer period remains open, the more an auction market of bids develops, resulting in higher prices being offered to a target company shareholders for their shares. A modest 15 day extension will not be enough to assure correction of the abuses arising from the current 20 day provision.

Surely, the Members of this Committee do not believe that a first bidder is automatically entitled to win and obtain control of a target company before competing bids at higher prices can develop. Nor that the first corporate suitor to propose merger terms to a target is entitled to a successful bid.

Congress has never spoken with regard to an appropriate minimum offering period. The current 20 day minimum offering period is merely part of an SEC fraud rule that does not confer any right to bidders to make and complete a tender offer within such 20 day period. Previous Committee hearings have certainly developed an adequate hearing record to justify a congressional mandate of a minimum 60 day offering period.

ABUSIVE DEFENSIVE TACTICS

Target company responses to hostile bids involve defensive tactics traditionally regulated by state corporation law. Section 8 of the legislation sets certain limits on the ability of target companies to employ the use of greenmail, golden parachutes, and poison pills during the course of a takeover. While NASAA would have serious reservations about any encroachment through federal legislation into state law concerning corporate governance, we believe that if S. 1323 is adopted in its entirety as currently proposed, and if additional language we suggest below is incorporated into this Section and Section 12, we would accept the very carefully framed and circumscribed anti-fraud provisions of this Section as serving the public interest and the interest of investors and shareholders.

We suggest the following additional provisions be added to Section 8:

- that the shareholder ratification currently provided for greenmail be extended to apply to the golden parachute and poison pill plan limitations;
- that language be added providing that the federal minimum standards concerning potentially abusive

defensive tactics *allow for state override* of these provisions if a state enacts legislation in substantial compliance with, or stronger than, the minimum federal standards. This type of language has been incorporated in other federal legislation where state and federal jurisdictions are involved, including the Secondary Mortgage Market Enhancement Act of 1984.

The absence of state takeover law generally, and law respecting defensive tactics specifically, stems from restrictions placed on the states in the Supreme Court's 1982 plurality decision in *MITE*. The more recent Court decision in the *CTS* case now properly again gives the states the green light to enact takeover statutes, including laws applying to defensive tactics employed by targets. States should now act under this unambiguous reaffirmation of state authority to amend their state corporation laws as they determine will best protect shareholders.

INSIDER TRADING

We are hopeful that the increases in penalties and sanctions for insider trading provided for in the legislation will have the effect of deterring would-be inside traders from engaging in such manipulative and abusive activities. Taken in conjunction with the takeover reforms provided for in this legislation, the result should be a chilling effect on insider activity. Enactment of the tender offer reforms in S. 1323 should significantly curtail the ability of a network of professional market participants from acting in concert merely to enrich themselves at the expense of other individuals, companies and the economy.

STATE ROLE

Finally, insofar as this testimony focuses on specific provisions in S. 1323, we welcome Congressional affirmation of the state role in the regulation of tender offers, as contained in Section 12 of the legislation. This Section specifies that no provisions of the Williams Act or rules or regulations issued thereunder would invalidate state laws unless the state law would preclude compliance with the filing, disclosure, procedural or anti-fraud requirements of the Williams Act.

We suggest, however, that this language be more precise.

First, we encourage you to adopt the state affirmation language in Senator Sanford's bill, S. 1324, because of its clarity and precision. I refer you to paragraphs (a) and (d) in Section 14 of the Sanford tender offer reform proposal. It amends the 1934 Act with language which acknowledges in (a) that "The Congress declares that the continued regulation by the several States of matters involving the internal affairs of governance of corporations organized under the respective laws of such States is in the public interest..." Paragraph (d) contains definitional standards stating that "For purposes of this section, the internal affairs or governance of a corporation shall include, but not be limited to, matters relating to the voting rights of security holders, mergers and other business combinations and the approval thereof, the rights and obligations of controlling or other significant shareholders, and other matters relating to the control, management or government of such corporations or to the relative rights and obligations of, and between and among, security holders, directors, officers and their corporations."

The inclusion of this language will effectively prohibit any attempts at back-door preemption of the states through promulgation of a rule prohibiting the operation of a voting rights corporation law statute similar to the Indiana law involved in the Supreme Court's recent *CTS* decision.

Alternatively, language in S. 1323 can be made more precise by deleting references to Sections 13 and 14 of the 1934 Securities Exchange Act, and inserting in its place "in this title." Deleting reference to Sections 13 and 14 and adding the suggested phrase will have the same effect as the proposed language in S. 1324, i.e., it would effectively insulate attempts to prohibit state voting rights statutes.

Lastly, equivalent state law enabling language in the securities realm is currently provided for in Section 28(a) of the federal Securities Exchange Act of 1934. We suggest today, as we have previously, that no matter what language is ultimately adopted, the state enabling authority language be added as a separate paragraph following Section 28(a) of the 1934 Act, rather than adding a new Section 36 to the Act.

The emerging state role in the regulation of tender offers is indicative of the leading role the states have historically played in the regulation of securities. In 1911, long before the birth of the federal SEC, Kansas adopted the first law requiring the licensing of broker-dealers and their agents and state registration of securities offerings. Since then, investors have relied upon the states to protect them from unscrupulous salesmen peddling worthless securities and to ensure the integrity of the marketplace.

Early state laws did not address the takeover issue for the simple reason that in those days the securities markets were generally used to raise capital, not as a place where companies would battle for control of one another. Eventually, battles for control of corporations shifted to the securities markets. The weapons became the tender offer, a call to shareholders to sell their stock to a bidder seeking control of a company, and the proxy fight, a battle for shareholder votes to topple company leadership.

Alarmed by the proliferation of hostile takeovers and concerned that there was not adequate protection of investors in the process, 36 states passed takeover reform measures in the late 1970's and early 1980's. In 1982, the Supreme Court struck down the Illinois takeover law because elements of it conflicted with both the Williams Act and the Commerce Clause of the Constitution. But states could not and did not sit back and watch as companies and investors in their jurisdictions were victimized by abusive takeover tactics. State legislatures went back to the drawing boards and drafted new takeover statutes designed to meet the Supreme Court's objections. In the last five years, 21 states have passed what has become known as the "second generation" of state takeover laws. The CTS decision now sets the standard for state/federal responsibility on takeover law under the Commerce Clause.

The Congress, and this Committee specifically, should be commended for focusing public attention on the abuses in the marketplace and undertaking a major effort to correct them. It seems that everyone, with the possible exception of the most unprincipled of market participants, would agree that we now finally understand a paradox: a market without rules is not free -- it becomes the captive of manipulators. It is also agreed in history, law, judicial decisions, and regulatory practice that state and federal authorities must make and implement the rules if the public interest is to be well served.

FURTHER STEPS

We appreciate the effort you have exerted to draft a bill that comprehensively deals with abuses in the takeover process. But we urge you to go further. Manipulation of the takeover process is symptomatic of the widespread and chronic abuses of investors' rights and of the public interest present today in our capital markets. We would like to suggest several additional issues Congress might appropriately include in this comprehensive legislation intended to restore marketplace integrity and investor protection.

SEC-State Cooperation. The SEC has only ten regional offices, and most of its staff is housed in Washington, D.C. and New York. By contrast, the state securities agencies, whose staffs account for approximately a third of the entire government securities regulatory personnel, operate in every state, close to business and public investors -- and to fraud when it occurs. It's easy to understand that the regulatory system will operate

best when its components, state and federal, cooperate to the fullest.

As the system currently works, the states have often been denied timely access to information needed to catch crooks. There have been instances in which state securities administrators have been forced to obtain critical and time sensitive enforcement-related information from the SEC under Freedom of Information Act requests. We are encouraged to see that there is some movement in a positive direction from the SEC concerning information sharing with the states. According to recent correspondence, the SEC may now be prepared to provide expedited state access to nonpublic information and will attempt to minimize restrictions on state use of this information. The system has not gone into effect so we are not able to evaluate its effectiveness. Under the current system, in one instance it took six months for a state securities division to get necessary information. When the information is often needed yesterday, this SEC practice is a hindrance to effective law enforcement. If the law requires time-consuming, formal requests for information from fellow law enforcement officers, the law should be changed; if the problem arises from SEC interpretation of the law, Congress should clarify its intent that the SEC should, on a routine basis and in a timely manner, share information with the states.

We would like to see the SEC implement the type of cooperative programs we now undertake with the federal Commodity Futures Trading Commission (CFTC). The states and the CFTC operate several highly successful investor protection programs, including undertaking joint investigations and enforcement actions; CFTC training seminars for state enforcement personnel; and the CFTC provides expert witnesses and analysts to the states. In addition, the CFTC has raised the level of cooperation to new heights by establishing a formal State-CFTC Advisory Committee which meets on a regular basis to discuss issues of mutual concern. Certainly, implementation of these types of programs between the states and the SEC would enhance investor protection.

Standard operating procedure currently dictates that when the SEC releases proposed rules and regulations for public comment, the states are afforded no greater opportunity to comment than are Ivan Boesky, Dennis Levine, Martin Siegel, or "Joe Blow." Generally, we do not have the benefit of advance knowledge of the proposed rules and regulations, no matter what impact they may have on the public whose protection is also our business, or on our own laws and regulations. There have been exceptions to the standard practice, including an instance during the last year in the area of regulation of financial planners and investment advisers. The SEC was drafting rules to implement a series of exemptions from federal registration requirements for a substantial number of investment advisers, conditioned upon state registration of such advisers. Here, the Commission took the unprecedented position of submitting the proposed rules to the states for comment before releasing them for public comment. The SEC should be instructed to promote such rulemaking coordination and cooperation with state regulators on a routine basis: the public interest is thereby better and more efficiently served. The states should be afforded a role in the entire rulemaking process, including formulation of the rule concept and the actual drafting of the rule.

EDGAR. As you know, one of the Commission's major priorities in recent years has been the EDGAR (Electronic Data Gathering and Retrieval) project. EDGAR has the potential for significantly reducing staff time, registration paperwork, and clearly should benefit the securities industry as well as regulators. But for EDGAR to become a comprehensive and successful system, the states must be integral parts of the federal system rather than adjuncts. The point is so obvious as to defy argument: the states and the SEC must work in tandem if the final stage of review, that which determines when an issue will become available to the market, is to be conducted and completed in a timely, efficient, and coordinated manner benefitting industry and the public.

The central defect in the proposed EDGAR structure is that the states would be denied direct access to the SEC's EDGAR central processing unit. Instead it is proposed that the data be transshipped to a separate computer and disseminated to the states from that point. This will be costly, duplicative and, we fear, unworkable. We remain optimistic that we can work with the SEC to develop an effective system. Unfortunately, the currently proposed plan falls far short of the public's needs. To remedy this will require that the states participate as partners in EDGAR and that we be involved now in the planning and development of the system. We request that Congress instruct the SEC to design the EDGAR system in such a way that the states are integrated as co-regulators.

Prospectus Delivery. Another crucial issue relates to disclosure. For an investor to benefit from the full disclosure system employed by the SEC, he or she must have timely disclosure and must understand that disclosure. A form filed with the SEC does not reach the average investor. A prospectus generated under the disclosure requirements is almost always delivered after an investment decision has been made. The odds are clearly stacked against the unsophisticated investor, and competent, objective advice is costly. Delivery of a prospectus is deliquent in practice and it is now proposed that the policy standard for delivery not currently enforced be further relaxed. We think this is the type of deregulatory effort that should be vigorously opposed in the interest of the investing public.

Furthermore, the prospectus delivery requirement should be strengthened to provide for investor receipt of the prospectus before the investment decision.

Self Regulatory Organizations. It is no surprise that as the Commission's budget and resources have failed to keep up with the expansion of the market, the self regulatory organizations (SROs), as well as the states, have had to take greater responsibilities. But we are concerned that the self regulatory organizations are operating without proper oversight by the Congress or the SEC.

Self regulatory organizations are complements to government regulation, and not substitutes for such regulation. A properly functioning SRO works in conjunction with federal and state regulators to administer regulatory programs by imposing qualifications and standards, as well as assisting government regulators in policing the profession's sales practices and ethics. An SRO that is only responsive and accountable to the federal government ignores a vital component of the regulatory equation.

We suggest that our common interest in investor protection would be better served if existing SRO's were instructed to be responsive and accountable also to the states. The SRO's should share with the states information concerning investigations initiated, customer complaints, and disciplinary actions; the states should be consulted in the SRO rulemaking process to ensure compatibility with state law; and the scope of SRO inspection programs should be expanded to include violations of state law, with violations reported to the states on a regular and timely basis. An example of how SRO policymaking can adversely affect the states is the case of marketplace competition which has resulted in the exchanges lowering listing requirements. States now exempt exchange listed securities from registration requirements; lowering the listing standards has an immediate effect on state regulation yet we have no input into such policy decisions.

We respectfully request that Congress not only mandate sro cooperation and coordination with the states, but that Congress work with the states to develop the appropriate mechanisms to accomplish such goals.

Arbitration. The Supreme Court's recent decision, which effectively establishes arbitration as the only vehicle through which disputes between investors and brokers can be resolved, necessitates that the arbitration process be, and be perceived to be, fair and impartial. We invite Congress, the SEC, the sros, and other interested parties to join us in examining this issue and developing criteria, procedures and safeguards that should be required in the arbitration process.

hundred workers are out of work now. They had to cut their expenditures for research, for advertising and for training and they have encumbered a debt interest of $1 million per day—all in the interest of an efficient marketplace.

After defeating a takeover attempt, Owens-Corning Fiberglas was forced to restructure and cut its work force by 13,000 workers worldwide, almost half of its total employee force. Its vaunted research and development commitment, which had made it an innovative industry leader and helped build its business dominance, was cut in half, causing hundreds of workers in central Ohio to be thrown out of their jobs.

Equally important, the legislation that we are considering here today reflects the critical role of the States in this entire process. Twice in 1983, the National Association of Attorneys General passed resolutions urging Congress to adopt legislation which expressly authorizes State regulation of tender offers so long as that regulation does not make it impossible to comply with Federal securities regulation. In February of this year, the National Governors' Association adopted a similar resolution sponsored by my own Governor, Governor Richard F. Celeste.

In addition, our resolution urged amending the Williams Act to remove barriers to State regulation that are imposed by the commerce clause. I am pleased to note that your legislation, Senator Proxmire, does reserve the appropriate State role and I thank you for that.

Since those resolutions were passed, the Supreme Court of the United States handed down the remarkable and, in my opinion, extremely wise opinion in the *CTS* case. This decision upheld the constitutionality of Indiana's Control Share Acquisition Act and affirmed the right of States to regulate some aspects of takeover attempts.

I was particularly pleased with this action because I am currently defending Ohio's law, which is similar in many respects.

As far reaching as the *CTS* decision might prove to be, it is still only one court case which, technically, applies only to the facts of it. Corporate governance traditionally has been left to the States. Thus, it is very appropriate and timely for Federal legislation to specifically address the States' rights to pass laws regulating tender offers and other internal corporate affairs.

My thoughts on many of the provisions in the bill are contained in my more detailed written testimony, but I would offer one suggestion that should be highlighted. Because these takeovers can have such broad ramifications for communities, I believe that a community economic impact statement should be required early in the process. This statement would disclose plans to close plants, terminate workers, seek modifications of collective bargaining agreements or sell the target company's assets to pay for the acquisition, in addition to some other financial data.

It is vital that communities, as well as shareholders, have this information to be able to make an informed and rational decision on the impact of the takeover.

In closing, Mr. Chairman, I would like to thank you and the other members of the committee for your leadership role in this issue. It is of very high concern to everyone, including, as you've heard already, Senator Metzenbaum from my own State of Ohio, who also has sponsored legislation on this subject. I know you will continue to work to achieve much-needed reform in this area and I will be happy to work with you in any capacity that I can to achieve those goals.

Thank you very much, Mr. Chairman.

[The complete prepared statement of Anthony J. Celebrezze, Jr., follows:]

The Chairman. Thank you, Mr. Celebrezze.

Our next witness is Jim Edgar. Jim, your Senator, Alan Dixon, is a member of this committee and he was here and he complimented you on your testimony and regretted that he couldn't remain.

I see they have named a system after you, the EDGAR system, already referred to as a matter of fact by Mr. Bell, Electronic Data Gathering and Retrieval. I'm sure your mother had that in mind when she named you.

Mr. Edgar. Well, one night during the last campaign on CBS evening news they had a teaser and it came on and said, "Problems with SEC, that's an abbreviation for Secretary, 'Edgar,'" and I was kind of worried about what I had done to get national notoriety, so it has its ups and downs. [Laughter.]

The Chairman. Well, all of us Senators are trying to get national notoriety at any cost, so you give us a tip here.

STATEMENT OF JIM EDGAR, REPRESENTING THE NATIONAL ASSOCIATION OF SECRETARIES OF STATE

Mr. Edgar. Mr. Chairman and members of the committee, I am Jim Edgar, Secretary of State of Illinois.

[The complete prepared statement of Jim Edgar follows:]

Attorney General
Anthony J. Celebrezze, Jr.

COMMENTS OF ANTHONY J. CELEBREZZE, JR.
ATTORNEY GENERAL OF OHIO ON S. 1323
SUBMITTED TO THE COMMITTEE ON
BANKING, HOUSING & URBAN AFFAIRS,
UNITED STATES SENATE
JUNE 23, 1987

I appreciate this opportunity to present more fully my views on Senate Bill 1323, concerning regulation of hostile tender offers. Although I am of the opinion that there are certain crimes and abuses in hostile tender offers which must be addressed by federal legislation, I must also urge caution against unwarranted interference with state statutes, which also have a significant and irreplaceable role to play in the overall regulatory scheme. I am pleased to note that, overall, this legislation recognizes the proper balance between state and federal responsibilities.

I have not taken a position on each element of the bill, as I have not reached a conclusion as to the advisability of each and every provision.

Section 2. Findings and Purpose.

The findings portion of the bill outlines clearly the abuses attendant to some hostile takeovers and the necessity of legislation to address those abuses.

Section 3. 10-day Window; Contents of Report.

The existing 10 day window for filing under §13(d)(1) permits a raider to acquire sufficient stock before public disclosure to virtually assure the ability to put a company into play. Closing the window to one trading day and preventing further acquisitions until the filing and a public announcement take place prevent the bidder from making a mockery of the reporting requirement. The expedited filing should also reduce the opportunity for insider trading. Additionally, it will reduce a raider's ability to extract greenmail, because there would be reduced opportunity for block acquisitions at pre-disclosure prices. Moreover, it is necessary to have the provision in the bill requiring those acting in concert in buying the stock to be treated as a single entity to prevent end-runs around this reporting requirement.

I also support the requirement that a purchaser make a meaningful and binding statement as to the purpose of the acquisition to allow the shareholders, the target, and the communities to accurately assess an acquisition of stock.

To make meaningful any disclosures regarding financing, I encourage consideration that disclosure of plans or arrangements to finance debt incurred in a tender include representations as to whether a restructuring of the target, including the sale of its assets, will be the source of any of the funds. Additional economic impact statements should be required for the purpose of revealing plans for plant closures, layoffs, relocation of headquarters, and other major changes in the business. In order to keep this requirement realistic, projections and plans should be for no longer than two years.

Section 4. Time for Filing Amendments

The requirement that amendments be filed within one trading day is consistent with the purpose of full disclosure embodied within the Williams Act, and ensures release of information while it is still fresh and meaningful.

Section 5. Enforcement Measures

The six-month waiting period imposed on persons who state that they have an investment intent in the initial filing certainly encourages honesty in this regard, and prevents deception of the market, shareholders, and communities. The current statute does not penalize statements which sidestep full disclosure of actual intent.

Section 7. Tender Offers

Extension of the Minimum Offering Period

I have two comments on the requirement that a tender offer be held open for a minimum of thirty-five business days. First, I believe it is essential that all people affected by a tender offer receive sufficient time for calm, deliberative reaction and planning. If time, plenty of time, is guaranteed, then I believe some of the defensive abuses would be abandoned as no longer necessary. Especially in states such as Ohio, which require a shareholder vote to permit a consummation of a tender offer, time for dissemination of information from both sides, tends to curtail the need for scorched earth and other extreme defenses. Certainly, thirty-five business days (about forty-seven calendar days), is an improvement over the SEC's regulatory minimum of twenty business days (which is approximately twenty-eight calendar days). Nonetheless, I believe that at least another five business days should be added, for a total of forty business days. This would provide a little less than two calendar months, which is not an excessive amount of time when the fates of thousands of people are being decided. An even longer minimum period may be advisable.

Secondly, I believe that the record must be absolutely clear as to the meaning of any change in the minimum offering period. Any change must and will be read light of the Supreme Court's decision in *CTS Corp.v. Dynamics Corporation of America*, ___ U.S. ___, 107 S. Ct. 1637, 95 L.Ed. 2d 62 (1987), decided April 21 of this year. In that decision, the court clarified that the 20-day period was merely a guarantee to offerees that an offer would be open for a certain time, and not a guarantee to offerors that the sale could be completed immediately at the conclusion of that period. It is arguable that a legislative change to the 20-day period could be perceived as an overruling of the *CTS* court's construction, and the minimum period would once again be construed as providing a guaranteed day for purchase by the bidders. The importance of this consideration is best understood in the context of state statutes regarding takeovers. The *CTS* court upheld an Indiana statute requiring a shareholder vote on an acquisition within 50 days after the offer commenced. Because this was within the SEC's 60-day maximum time frame, the statute was upheld. The states' ability to pass such laws must not be jeopardized by the proposed legislation. If the minimum number of days is changed, I urge clarification that the minimum does not guarantee a bidder the right to buy tendered shares on the thirty-sixth, or forty-first, business day after the expiration of the minimum offering period.

Prohibition of "Creeping Tender Offers" and "Sweeping the Streets" Transactions.

To preserve the integrity of the Williams Act tender offer regulations, I believe that it is valid to require that purchases of in excess of fifteen per cent of the stock be made through a tender open to all shareholders. This provision would prevent creeping tenders and street sweeps, acquistions which illegitimately avoid statutory disclosure requirements.

One criticism of this type of provision is that it would permit two-tier and partial tender offers, which many have characterized as being inherently abusive and unfair to shareholders. The importance of state laws in governing

takeovers becomes apparent in this light. In Ohio, such coercion is prevented by statutes requiring shareholders to vote on control share acquisitions. Shareholders vote even though they have tendered their shares. The provision is an example of how state and federal securities laws are far from being mutually exclusive, and can be a symbiotic network ensuring both efficient markets and investor protection.

My comments are conditioned on the understanding that the proposed amendment would not necessarily require that the tender be for all shares, merely that it be open to all shareholders. I have not fully analyzed the consequences of requiring that a tender for all shares be made once a certain percentage of ownership of achieved.

Section 8. Actions by Issuers.

At this juncture, I must again caution against the danger of overruling the *CTS* decision. The *CTS* opinion removed any doubt that the states have the ultimate responsibility for the corporations they charter. This responsibility includes taking credit for pro-competitive legislation which evenhandedly governs the "market for corporate control," including, I believe, Ohio's laws concerning tender offers. The responsibility also extends to taking the blame for any poor or unconstitutional state statues, which the courts are constantly asked to review. In short, appropriate federal legislation is necessary and called for. The Congress should, however, tread lightly when there is danger of interfering with the states' ability to govern the internal affairs of its corporations.

This caution to tread lightly extends to the issues addressed in Section 8, that is, defensive abuses. Of course, I do not in any way condone excessive greenmail paid merely in order to retain entrenched management. Nor do I unconditionally sanction poison pills or golden parachutes. I must note however, that these are precisely the problems with which state legislatures are wrestling today, and I believe that this is precisely the arena where the wrestling should be done. My own state is even now debating greenmail legislation. In addition, Ohio has already enacted legislation regarding poison pills which may conflict with the proposed federal legislation. Potentially abusive defenses are an integral part of the venerable corporate concepts of fiduciary duty and business judgment. State legislatures and state courts have been developing these concepts for decades, and they are part of the internal affairs of a state corporation. Again, the Supreme Court in *CTS* has reaffirmed the primacy of the states is governing chartered companies' internal affairs. I am of the opinion that the federal legislative authorities should be very careful before adopting any statute which is a move towards the federalization of corporate law. In the laboratories of the 50 states, each will develop solutions which work for them. If a particularly wise one is found, other states will follow suit.

Moreover, federal legislation which concerns the internal affairs of state corporations is in at least philosophical conflict with Section 12 of this bill. As I discuss more fully below, Section 12 reserves to the states the right to regulate its chartered corporations. Yet, in this same bill, the federal government is assuming the right to so regulate. I encourage this committee to reexamine Section 8 in this light, and urge a conclusion that the issues addressed therein be left with the states, where they belong.

Section 10. ERISA Amendments.

My comment on the amendments to ERISA are quite brief, as these concern matters of federal statute. I would note, however, that the amendment which enables ERISA fund managers to vote against a tender offer is consistent with recent changes in Ohio law. The Ohio General Assembly has provided that directors of a corporation are permitted to consider factors besides mere maximization of shareholder wealth, including the long-term interests of the corporation. *See* Ohio Revised Code §1701.59(E).

Section 11. Increased Penalties for Insider Trading, Perjury and Obstruction of Justice.

As the Chief Legal Officer of the State of Ohio, I certainly do not condone cheating while "doing business." I do support stiff penalities for those who would undermine the world's greatest system for investment by subverting the system to illicit personal gain. Such criminals must be punished, and be certain of that punishment.

Section 12. Role of State Law.

For years, states were stymied in their attempts to address problems attendant to hostile takeovers because of the 1982 Supreme Court decision in *Edgar v. MITE Corp.*, 457 U.S. 624 (1982), which struck down an Illinois statute regulating takeovers. Federal courts throughout the land applied the case expansively, and invalidated inumerable state laws governing takeover situations. Twice in 1983, the National Association of Attorneys General passed resolutions urging the Congress to adopt legislation which expressly authorizes state regulation of tender offers and control share acquisitions so long as such regulation does not make it impossible to comply with federal securities regulation. In February of this year, the National Governors Association adopted a similar resolution, calling for federal legislation to expressly authorize state tender offer statutes and to amend the Williams Act to remove barriers to state regulation imposed by the Commerce Clause.

Since those resolutions were passed, the Supreme Court handed down its decision in the case of *CTS Corp. v. Dynamics Corp. of America*. In this opinion, the Supreme Court upheld an Indiana statute governing tender offers, and repudiated lower court decisions which had broadly applied *MITE* when holding that states could not interfere in the "market for corporate control" without running afoul of the Commerce Clause. Likewise, the Supreme Court held that the Indiana statute did not violate the Supremacy Clause because it was physically possible to comply with both the federal regulatory requirements and the state provisions.

As you can probably appreciate, states with legislation similar to Indiana's, including Ohio, are delighted with the *CTS* decision. Although I support Section 12, I must emphasize that it is a fundamental premise to my support that its purpose and interpretation are, at a minimum, to codify the holding in *CTS*. Particularly, it is my understanding that the section seeks to legislate that local governance of the internal affairs of a state's chartered corporations is not violative of the Commerce Clause of the Constitution of the United States. Second, it is my understanding that the amendment is intended to shield state laws from attacks under the Supremacy Clause as long as a state statute does not make it impossible to comply with federal securities laws relating to filing, procedural, disclosure, or antifraud requirements. Legislative affirmation of the principles affirmed in the *CTS* decision will ensure their broadest possible application in the securities arena, and will prevent limitation, constriction, or unduly narrow construction of the principles in lower court decisions.

Mr. Chairman, this foundation of understanding of Section 12 is essential to the support of the National Association of Attorneys General and myself. I urge this committee to ensure that the legislative history of this Section reflects this interpretation, lest courts misconstrue the scope and purpose of the amendment.

Conclusion

I believe that the states and the federal government each have vital roles to play in regulating corporations and attempts to change control of them. By carefully structuring legislation appropriate to each role, the strength and vitality of the American economy will be preserved, enabling us to compete efficiently and effectively in the increasingly global markets. Thank you for the opportunity to present these views.

NATIONAL ASSOCIATION OF ATTORNEYS GENERAL
SUMMER MEETING
. June 22-25, 1983
Asheville, North Carolina

RESOLUTION

STATE JURISDICTION TO REGULATE CONTROL SHARE ACQUISITIONS AND TENDER OFFERS

WHEREAS, the recent U.S. Supreme Court case of Edgar v. Mite, 102 S. Ct. 2629 (1982) has held the Illinois tender offer statute invalid as a prohibited burden on interstate commerce; and

WHEREAS, the effect of such holding has been to eradicate previously enacted state tender offer legislation, and has provided an impetus for subsequent lower federal court decisions to go beyond Mite; and

WHEREAS, the result of such judicial decisions has been to significantly decrease investor protection, to wit:

1. Shareholders of target companies have insufficient time to make their investment decisions;

2. It is now unlikely that the information provided to enable shareholders to make those decisions will be as accurate and complete as that mandated by state takeover laws; and

3. Shareholders of target companies are no longer able to realize the full value of their investments since the companies do not have sufficient time in which to secure competitive bids; and

WHEREAS, state takeover acts may be considered necessary to slow down the tender offer process, which, without such regulation, may result in the raiding of corporate treasuries, securities of questionable value being exchanged for securities of sound companies, the closing of local plants and offices, and further concentrations of economic power; and

WHEREAS, the particular economic and social climate of each state renders a decision to regulate tender offers peculiar to that State;

NOW, THEREFORE, BE IT RESOLVED, that the National Association of Attorneys General:

1. Strongly supports the adoption of federal legislation that expressly authorizes state regulation of tender offers and control share acquisitions so long as such regulation does not make it impossible to comply with federal securities regulation;

2. Urges Congress to amend the Williams Act, specifically to remove all barriers to state regulation imposed by the Commerce Clause in this area; and

3. Authorizes the General Counsel to transmit these views to the Congress, the Administration, and other interested officials.

NATIONAL ASSOCIATION OF ATTORNEYS GENERAL

Winter Meeting
Honolulu, Hawaii
December 5-9, 1983

RESOLUTION

I

STATE JURISDICTION TO REGULATE TENDER OFFERS AND CONTROL SHARE ACQUISITIONS

WHEREAS, the National Association of Attorneys General, on June 25, 1983, resolved to support federal legislation that would authorize state regulation of tender offers and control share acquisitions so long as such regulation does not make it impossible to comply with federal securities regulation; and

WHEREAS, the Securities and Exchange Commission Advisory Committee on tender offers issued its Report on July 8, 1983, which Report recommends the following:

1. Express federal preemption of state regulation of tender offers and control share acquisitions;

2. Acceleration of the tender offer process especially as to securities exchange tender offers; and

3. Generic federal corporation regulations governing matters such as high-vote provisions, advisory votes by share holders, repurchase of shares, and the necessity to proceed by tender offers for acquisitions above a given threshold; and

WHEREAS, the Attorneys General view these issues as fundamental and the Advisory Committee's recommendations as unsound and at variance with vital state interests; and

WHEREAS, the U.S. Congress has determined that these issues are of such significance that joint hearings of the Senate Subcommittee on Securities, and the House Subcommittee on Telecommunications, Consumer Protection and Finance will be held in early 1984;

NOW, THEREFORE, BE IT RESOLVED, that the National Association of Attorneys General:

1. Reaffirms its commitment to the adoption of federal legislation that would expressly authorize states to regulate tender offers and control share acquisitions, so long as such regulation does not make it impossible to comply with federal securities regulation;

2. Urges Congress to hold the above-referenced hearings as soon as possible to consider the views expressed herein and to amend the Williams Act specifically to remove all barriers to state regulation imposed by the Commerce Clause in this area;

BE IT FURTHER RESOLVED, that the National Association of Attorneys General authorizes its General Counsel to transmit these views to the Congress, the Administration, and other interested officials.

The worst consequences of these abuses are not necessarily happening in the boardrooms of Wall Street. They are felt in the neighborhoods and communities of our states.

We at the state level are closer to these harmful consequences, closer to the working people they effect, and closer to the management of local companies. We have traditionally been the level of government to which citizens turn for protection.

In Senate Bill 1323, you have an opportunity to assure the continued role of a vital and effective resource for combatting inequitable business practices.

After decades of involvement in this area, the states have a wealth of experience and expertise. By not assuring the states continued role, you would be depriving citizens of the protection of one-third of the personnel nationwide who currently regulate corporate governance.

We support Senate Bill 1323 because it allows the state and federal governments to remain partners in the regulation of hostile takeovers.

State and federal governments now jointly regulate environmental protection, housing, labor, transportation, employment and health issues. We should continue that cooperation in corporate regulation, as well.

I join with my colleagues in state government in asking you to support this legislation because it improves federal regulation and it preserves the critical contribution of the states in the protection of citizens from takeover abuses.

Again, on behalf of the nation's Secretaries of State, let me commend the members of this committee for developing legislation which answers concerns about hostile takeovers, without stripping states of an essential power.

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The CHAIRMAN. Thank you very much, Mr. Edgar.

Our final witness is Richard Geltman, general counsel for the National Governors' Association.

STATEMENT OF RICHARD B. GELTMAN, GENERAL COUNSEL, AND STAFF DIRECTOR, COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGICAL INNOVATION, NATIONAL GOVERNORS' ASSOCIATION

Mr. GELTMAN. Mr. Chairman, without objection, I'd like to have my written remarks reflected in the record.

The CHAIRMAN. They will be included in full in the record.

Mr. GELTMAN. Thank you, Mr. Chairman, and thank you for inviting a representative of the National Governors' Association to testify before you today on regulating hostile corporate takeovers.

NGA RECOMMENDATIONS

In summary, NGA recommends increasing disclosure requirements, providing for equal treatment of shareholders, requiring an economic impact statement, prohibiting the use of employee pension funds in takeover financings, affirmatively expressing State authority over corporate governance issues, and not preempting State authority over corporate defensive tactics.

To date, there have been a number of studies of tender offers and takeovers. From those studies it does not seem possible to conclude that takeovers in general are harmful to profitability or the economy. Some individual takeovers appear to work out well and others appear not to. However, there seem to be particular takeover practices that provide advantages to bidders to the disadvantage of shareholders and other investors. The Governors support congressional efforts to make hostile takeover practices more fair and less damaging to targeted corporations, their employees, and to affected communities.

In particular, the current 10-day window to meet disclosure requirements under section 13(d) of the Securities Exchange Act has proven in some cases to be ineffective in supplying essential information to shareholders and the public in a timely fashion. We believe the time for filing the section 13(d) form should be reduced. It also makes sense to prohibit further purchases exceeding the threshold amount until the required disclosure is made.

We support the elimination of bidder acquisition techniques that treat public investors differently. Unequal treatment of target company shareholders result in some investors being excluded or unfairly disadvantaged. It is appropriate to give all shareholders an equal opportunity to participate in a tender offer. "Creeping tender offers," "two-tier" offers, and "sweeping the street" techniques should not be permitted.

The Governors are concerned with the local economic impact of tender offers and feel many investors, particularly local investors, share those concerns. Therefore, NGA specifically supports section 9(a)(2) of Senator Sanford's S. 1324 which requires the offerer to disclose plant closing, employment, and financing intentions.

Because of concerns for the rights and long-term welfare of resident employees, States are concerned with the use by either management of the target or the bidder to utilize excess pension fund assets partially to defend against or finance a hostile corporate takeover. It is appropriate for Congress, which has already preempted the States in this area, to act.

A principal area of concern to the States is their ability to continue to regulate techniques for effecting change in corporate structure.

While there is growing concern over defensive tactics employed by management of target companies, Congress should not itself, nor permit Federal regulatory agencies to, preempt State corporate regulatory authority. Section 14 of S. 1324, Senator Sanford's bill, concisely and clearly establishes the appropriate Federal-State relationship, and we support it. While CTS Corp. clarified *Edgar* v. *Mite,* to say that States might protect independent shareholders from the coercive aspects of tender offers by evenhanded regulation, there is still considerable doubt about what States can and cannot do. Section 14 is needed. Section 14 indicates that it is not Congress' intent to preempt State governance authority, and thereby removes any possibility that the Securities and Exchange Commission will by regulation attempt to do what Congress has chosen not to do. Moreover, it provides affirmative language that the States have the authority to regulate the internal affairs or governance of corporations, thereby removing the argument that the dormant commerce clause imposes limits on State actions in this area. The absence of significant State laws will inevitably lead to further tender offer abuses and erosion of public confidence in the integrity of the economic system and in the States themselves to which the public looks for protection against corporate abuses.

We oppose any preemptive language that would eliminate State regulatory authority over corporate defensive tactics, even if limited to antigreenmail, golden parachute, and poison pill provisions. States are the appropriate level of government to regulate corporate governance actions. First, States have the traditional role, responsibility, and expertise. Second, States have public policy interests in regulating the internal affairs of the corporations which they have created. Third, it is difficult conceptually and politically to say where Federal regulation of corporate governance should stop once it has begun. Fourth, State courts have provided judicial review of corporate conduct for years, and a body of law and expertise has developed. Are we now ready to abandon State courts for overburdened Federal courts? Fifth, under the State-adopted "business judgment rule," Federal and State courts have begun to shift the burden of persuasion to corporate managers to justify why defensive tactics do not present conflicts of interest. Sixth, hostile corporate takeover strategies and defenses change rapidly. As laboratories, States can adapt more easily and experiment, with fewer national consequences, so as to arrive at flexible, appropriate public policy responses. Seventh, public pension funds and shareholder groups are organizing and introducing new dynamics into management responses to hostile takeover attempts. These organized market participants are beginning to oppose the adoption of takeover defenses and other changes in corporate governance that diminish the rights of shareholders. And finally, as a result of the *CTS Corp.* decision, the States will no longer feel restrained by the limits that were thought to be imposed by the *Mite* decision. Given the recent decision—that is, April 21 of this year in CTS—it is appropriate to wait and see whether States choose to limit defensive tactics in any way.

Mr. Chairman, I would be glad to answer any questions. Thank you.

[The complete prepared statement of Richard B. Geltman follows:]

Statement of

Jim Edgar
Illinois Secretary of State
and
Vice President-Elect,
National Association of Secretaries of State

Mr. Chairman and Members of the Committee:

Good morning. I am Jim Edgar, Secretary of State of Illinois. I am here today representing the National Association of Secretaries of State.

Among the members of our organization, 40 Secretaries of State have responsibility for the regulation of corporate governance. That is why we appreciate this opportunity to testify on the subject of tender offer reform legislation.

Mr. Chairman, we appreciate what you and the members of this committee have done to focus attention on abuses in our capital markets. The newspapers have been filled with stories of hostile takeovers and insider trading, and we believe this committee has developed an appropriate response to public concerns.

We support Senate Bill 1323 for two reasons.

First, it would help restore stability and predictability to the market place.

Without this effort to restore investor confidence, we face a gradual decline in investments and a growing shortage of capital for existing business, new business ventures and the jobs they create.

Second, we support the legislation because it preserves the state's vital role in the regulation of securities and corporations.

Greater federal regulation is needed, but it should not come at the expense of state regulation. Investment activity has significant effects at the state level, and should therefore also be regulated at the state level.

Three years ago, we in Illinois saw firsthand how an inadequately regulated hostile takeover can inflict harm not only on a company, but on an entire community.

In the summer of 1984, Frantz Manufacturing Company became the target of a takeover attempt. Frantz is a medium sized business and a major employer in the small community of Sterling, Illinois. It makes garage doors and anti-friction products. It had strong earnings and over $8 million in liquid assets, which it had planned to use for investment in future development of the company.

Gaps in federal laws allowed a corporate raider to secretly acquire 51 percent of the company's stock. The raider planned a merger, followed by the sale of the garage door division to pay off heavy debts. Had the raid been successful, many in the Sterling community would have lost their jobs.

Frantz fought the raid successfully, but only after seven months in litigation and a cost of $26 million to buy out the raider.

Fighting that takeover put it heavily into debt and risked not only its economic future, but the economic future of an entire small town and hundreds of jobs.

This is only one example, but it illustrates a broader national problem being felt directly by citizens at the state level.

Hostile takeovers involve much more than paper transactions and board room intrigue. At their worst, they can reduce investment, they can cost people their jobs, and they can do harm to the economy.

Concern about such takeovers isn't new, of course. The federal Williams Act in 1968 attempted to regulate takeovers and tender offers. Many states, feeling the Williams Act was inadequate, passed laws of their own to protect citizens from raids on corporate treasuries and, more importantly, the closing of local plants and offices.

By the early 1980s, 36 states, including Illinois, had passed such legislation. However, in 1982, the U.S. Supreme Court handed down a landmark decision, ruling Illinois's 1978 law unconstitutional. In doing so, it sharply curtailed the role of all states in regulating hostile takeovers.

In a decision to which I have the dubious distinction of having my name attached -- Edgar v. MITE Corp. -- Illinois law was said to have conflicted with the federal Williams Act. It was also ruled that our law was unconstitutional because it interfered with interstate commerce.

The court did, however, recognize that states have a legitimate interest in regulating takeovers.

After that decision, the states went to work, rewriting legislation to conform to the limits set by the court. During the past five years, 21 states have passed new takeover laws.

Two months ago, the Supreme Court ruled in favor of the first of these new laws to reach it. This was an Indiana case -- CTS v. General Dynamics.

But, despite new state laws and despite the approval of the Supreme Court, it has been suggested that states be stripped of their authority to regulate tender offers and takeovers.

We urge you to preserve the vital role of the states in regulating corporations. The National Association of Secretaries of State has adopted a resolution which reaffirms our commitment to the adoption of federal legislation which expressly authorizes states to regulate tender offers and control-share acquisitions. The National Governors' Association and the National Association of Attorney's General have adopted similar resolutions.

States should have a say in investment activity which affects the jobs of their citizens and the management of companies within their boundaries.

But we also fully understand that states must stay within the same framework which limits federal regulation. We must remain neutral in any struggle between investors, shareholders and management.

The continuing need for state, as well as federal, regulation is clear. States began regulating securities long before the federal government, and for some good reasons.

National Governors' Association

Bill Clinton
Governor of Arkansas
Chairman

Raymond C. Scheppach
Executive Director

Testimony of

RICHARD B. GELTMAN
Staff Director
Committee on Economic Development and
Technological Innovation
NATIONAL GOVERNORS' ASSOCIATION

before the

Committee on Banking, Housing, and Urban Affairs
United States Senate

regarding

The "Tender Offer Reform Act of 1987" (S. 227),
The "Tender Offer Disclosure and Fairness Act
of 1987" (S. 1323), and
The "Corporate Takeover and Insider Abuse Reform
Act of 1987" (S. 1324)

June 23, 1987

HALL OF THE STATES · 444 North Capitol Street · Washington, D.C. 20001-1572 · (202) 624-5300

Mr. Chairman:

Thank you for inviting a representative of the National Governors' Association to testify before you today on regulating hostile corporate takeovers.

The states are interested in improving the United States' long-term competitive position in the global economy. This means that private American corporations must be able to attract capital in order to increase productivity. For corporations to attract investment, providers of debt and equity capital must have confidence that the financial marketplace works efficiently, fairly, and expeditiously. Increasingly, over the last five years investors and the public have been losing confidence in the securities markets. State and federal governments must now work together over the next two years to define the appropriate roles of the levels of government and the private sector and restore the confidence of the investment community.

Since 1933, the federal government has assumed the responsibility for assuring that securities markets operate fairly. In 1968, the Williams Act was enacted to regulate corporate takeovers. At that time, Congress indicated that it was passing the legislation to require full and fair disclosure of takeover activity for the benefit of investors, while providing the offeror and management equal opportunity fairly to present their case. It indicated that it avoided tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid. It is time to reexamine how effectively the Williams Act is working and whether further refinements are necessary.

To date, there have been a number of studies of tender offers and takeovers. From those studies it does not seem possible to conclude that takeovers, in general, are harmful to profitability or the economy; some individual takeovers appear to work out well and others appear not to. However, there seem to be particular takeover practices that provide advantages to bidders to the disadvantage of shareholders and other investors. The Governors support congressional efforts to make hostile takeover practices more fair and less damaging to targeted corporations, their employees, and to affected communities.

In particular, the current ten-day window to meet disclosure requirements under Section 13(d) of the Securities Exchange Act has proven, in some cases, to be ineffective in supplying essential information to shareholders and the public in a timely fashion. The National Governors' Association has no specific position on new disclosure requirements. However, we believe the time for filing the Section 13(d) form should be reduced. It also makes sense to prohibit further purchases exceeding the threshold amount until the required disclosure is made.

We support the elimination of bidder acquisition techniques that treat public investors differently. Unequal treatment of target company shareholders results in some investors being excluded or unfairly disadvantaged. It is appropriate to give all shareholders an equal opportunity to participate in a tender offer. "Creeping tender offers," "two-term" offers, and "sweeping the street" techniques should not be permitted.

The Governors are concerned with the local economic impact of tender offers, and feel many investors, particularly local investors, share those concerns. Therefore, NGA specifically supports Section 9(a)(2) of S. 1324, which requires the offeror to disclose plant closing, employment, and financing intentions.

Because of concerns for the rights and long-term welfare of resident employees, states are concerned with the use by either management of the target or the bidder to utilize excess pension plan assets partially to defend against or finance a hostile corporate takeover. It is appropriate for Congress, which has already preempted the states in this area, to act.

A principal area of concern to the states is their ability to continue to regulate techniques for effecting change in corporate structure. While the federal government has been the principal regulator of corporate securities since 1933, the states have been the exclusive lawmakers over internal corporate governance issues. For over 200 years, states have developed a comprehensive and balanced body of corporation laws and extensive expertise in their administration. Corporations are, in fact, creatures of state law and have no legal existence absent the granting of state charters. State corporate law has traditionally protected shareholders' rights by regulating the transfer and voting of shares, shareholders agreements and voting trusts, mergers, dissolutions, and the use of proxies. Federal expertise, on the other hand, is limited to securities disclosure requirements, tender offers and stock repurchases.

While there is growing concern over defensive tactics employed by management of target companies, Congress should not itself, nor permit federal regulatory agencies to, preempt state corporate regulatory authority. Section 14 of S. 1324 concisely and clearly establishes the appropriate federal-state relationship, and we support it. While *CTS Corporation v. Dynamics Corporation*, __ U.S. __ (April 21, 1987) clarified *Edgar v. Mite*, 457 U.S. 624 (1982), to say that states might protect independent shareholders from the coercive aspects of tender offers by even-handed regulation, there is still considerable doubt about what states can and can not do. Section 14 is needed. Section 14 indicates that it is not Congress' intent to preempt state governance authority, and thereby removes any possibility that the Securities and Exchange Commission will by regulation attempt to do what Congress has chosen not to do. Moreover, it provides affirmative language that the States have the authority to regulate the internal affairs or governance of corporations, thereby removing the argument that the dormant Commerce Clause imposes limits on state actions in this area.

We oppose any preemptive language that would eliminate state regulatory authority over corporate defensive tactics, even if limited to anti-greenmail, golden parachute, and poison pill provisions. States are the appropriate level of government to regulate corporate governance actions. First, states have the traditional role, responsibility, and expertise. Second, states have public policy interests in regulating the internal affairs of the corporations, which they have created. Third, it is difficult conceptually and politically to say where federal regulation of corporate governance should stop once it has begun. Fourth, state courts have provided judicial review of corporate conduct for years, and a body of law and expertise has developed. Are we now ready to abandon state courts for overburdened federal courts? Fifth, under the state-adopted "business judgment rule," federal and state courts have begun to shift the burden of persuasion to corporate managers to justify why defensive tactics do not present conflicts of interest. In *Norlin Corp. v Rooney Pace, Inc*., 747 F. 2d 255 (2nd Cir. 1984), the court placed the burden on the board of directors to demonstrate that the defensive actions they had taken were fair and reasonable. See also *Smith v. Van Gorkum*, 488 A. 2d 858 (Del. 1985); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A. 2d 946 (Del. 1985); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A. 2d 173 (Del. 1986); and *Hanson Trust PLC v. ML SCM Acquisitions, Inc.*, 781 F. 2d 264 (2nd Cir. 1986). Sixth, hostile corporate takeover strategies and defenses change rapidly. As laboratories, states can adapt more easily and experiment, with fewer national consequences, so as to arrive at flexible, appropriate public policy responses. Seventh, public pension funds and shareholder groups are organizing and introducing new dynamics into management responses to hostile takeover attempts. These organized market participants are beginning to oppose the adoption of takeover defenses and other changes in corporate governance that diminish the rights of shareholders. And finally, as a result of the *CTS Corporation* decision, the states will no longer feel restrained by the limits that were thought to be imposed by the *Mite* decision. Given the recent decision (April 21, 1987) in *CTS Corporation*, it is appropriate to wait to see whether states choose to limit defensive tactics in any way.

In summary, we recommend increasing disclosure requirements, providing for equal treatment of shareholders, requiring an economic impact statement, prohibiting the use of employee pension funds in takeover financings, affirmatively expressing state authority over corporate governance issues, and not preempting state authority over corporate defensive tactics.

Mr. Chairman, I'd be glad to answer any questions.

The CHAIRMAN. Thank you, Mr. Geltman, very much.

Mr. Bell, one of the arguments, against the bills before the committee will reduce the pace of corporate takeovers and they say that's bad for the economy.

As a State official with experience in that field, what is your response to the argument?

Mr. BELL. My response to that is that it is not bad. Our whole mandate and our whole existence for being is to provide for shareholder protection.

To the extent that you have a minimum of a 20-day window for making investment decisions with regard to a takeover, I think that investors are forced to make hasty decisions without the benefit of full information.

We believe that the marketplace and the investor should be provided all due deliberation in making these decisions.

The CHAIRMAN. So you see this legislation as designed to give the shareholders who make the choice more information and more time to hear both sides and so forth?

Mr. BELL. Absolutely.

The CHAIRMAN. Mr. Celebrezze, those who defend corporate takeovers argue that they force management to restructure the corporation even when the takeover is unsuccessful. I've noticed that a large proportion of the takeovers really are investment pools, that drive up the stock prices. The raiders make a lot of money and sell out and that's it.

Something like that happened with respect to the Goldsmith raid on Goodyear where there was probably greenmail paid, but also drove up the price of the stock temporarily and made some people rich in the short run.

EFFECT OF GALDSMITH RAID ON GOODYEAR

From your perspective, what was the effect of the Goldsmith raid on Goodyear? Will the company be more efficient or less efficient as a result of the raid?

Mr. CELEBREZZE. Mr. Chairman, I have some doubts that that company will ever recover from beating off——

The CHAIRMAN. I ask you that because it's in your State and you're an expert on it.

Mr. CELEBREZZE. Our experience was that Goodyear was forced to close down several plants. Thirty three hundred people lost their jobs. They severely curtailed their research efforts. Research is one of the strengths of this country. It's one of the things that's kept us on the leading edge technologically for years and years. And last, they have a debt service now that runs $1 million a day that they didn't have before.

The CHAIRMAN. In that connection, the debt service that runs $1 million a day means that's $1 million they can't put into R&D, that they can't put into manpower training, or into making their firm more efficient in other ways.

Mr. CELEBREZZE. Or providing jobs for people in our State and other States.

The CHAIRMAN. Mr. Geltman, some securities lawyers argue that the States have no legitimate role in legislation regulating corporate takeovers. They say that the Williams Act was carefully designed to maintain neutrality between the bidder and the target. They say the act is designed to allow stockholders enough time and enough information to evaluate takeover bids.

State laws, by way of contrast, tend to tilt the scales on the side of targets and against the raider. As a result, it's argued that the Williams Act should preempt all State laws for regulating corporate takeovers.

What's your response to that?

Mr. GELTMAN. I guess I would not agree with the conclusion that States are not being evenhanded. I think they are concerned about the shareholders, and the shareholders are both individual people who are already involved and aren't nearly as interested in protecting the management. I think to the extent that we've had some problems dealing with defensive tactics of present target corporations, a lot of that has been inhibited by the Supreme Court decision in *Edgar* v. *Mite* and now that the *Edgar* v. *Mite* decision is behind us, as a result of the *CTS* decision, I think we have to wait and see how a lot of the States do in regulating some defensive tactics which might very well be abusive.

The CHAIRMAN. Mr. Edgar, have you had a chance to review Congressman Dingell's bill on corporate takeovers? If so, what effect does it have on the role of the States?

Mr. EDGAR. I haven't specifically. It's my understanding, though, that it is silent on the role of the States and that is something that concerns most of us at the State level because we are afraid, whether it prohibits or it's silent, that will leave the implication that Congress does not want the States involved, and I think that would be a setback as great as the *Edgar* v. *Mite* setback was 6 years ago in the courts.

The CHAIRMAN. I don't know if you were here when Senator D'Amato was questioning the preceding panel, but he emphasized the argument that corporate takeovers do not cost jobs. He said that was one of the myths. He had a whole series of myths and he said that was a myth, that corporate takeovers cost jobs.

What's your view on that? Are job losses a myth or a fact?

Mr. EDGAR. Well, again, there are some cases where takeovers probably strengthen the company and jobs might be created, but there are also the other cases. An example is the one I gave of a small company. This isn't just a problem among the Fortune 500. This is a problem of all types of companies where that takeover attempt definitely weakened that company and I think has lessened its ability to expand and hire more people.

So there are many cases where these abuses lead to the loss of jobs.

The CHAIRMAN. Mr. Celebrezze, how about your experience in that area?

Mr. CELEBREZZE. Mr. Chairman, I would respectfully take issue with some of Senator D'Amato's comments.

Our experience just with Goodyear, 3,300 jobs; Owens-Corning, 13,000 jobs worldwide. I don't think that we are here to say that we should prohibit takeovers, period.

What we are here to say is that the raider in the night, gun-to-the-head, turn over your shares of stock or you're going to get left at the starting gate type of thing doesn't give anyone a chance to do the type of deliberation that usually goes into a business takeover.

I think they do cost jobs. They ruin communities and they are detrimental ultimately to the national economy of this country, if for no other reason than that they cut back on research and development funds that will keep our companies healthy and keep our companies at the leading edge of technology.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

The basic premise of the argument made by Dr. Sprinkel was that if there aren't any current problems in corporate takeover law—and he was reticent to accept that premise—that the solution should be through self-determination at the shareholder level or through State action, but "in the administration's view, either of these avenues is preferable to intrusive Federal regulation of corporate governance."

As representatives of States, do you believe there is an appropriate shared responsibility as among shareholders, States and the Federal Government, or that the Federal Government has an inappropriate and intrusive role which should be excluded?

ROLE OF FEDERAL GOVERNMENT

Mr. CELEBREZZE. If I could start out, Mr. Chairman, I think there is a shared responsibility. Traditionally, the States govern internal corporate affairs. We are the ones that charter the corporations. We deal with their structure and their internal affairs, but the Federal Government has controlled the financial markets, the stock exchange and that type of thing.

I think there is a very real partnership and a very workable partnership and I think this bill basically gets at creating that partnership or reinforcing it and that it's a very desirable thing.

Senator GRAHAM. Mr. Edgar?

Mr. EDGAR. Well, I agree. I think as one from State government, we at times like to say we can do it better, but I think realistically where we are in 1987, the federal system developed works best when we share our responsibilities and work together and I think we can do that. We've done that in the past. We do that in other areas.

Particularly in an area as complicated and as important as this, I think there is a need for that cooperation. So, again, that's why we are very supportive of this legislation, because I think it recognizes that partnership and there will be need to discuss back and forth as this legislation progresses through the Congress and even after its enactment, but that partnership I think will provide for a better, more effective enforcement as opposed to whether the Federal Government had complete control or the State governments.

Senator **GRAHAM**. Mr. Geltman.

Mr. **GELTMAN**. It seems to me that there are a number of aspects to the problem before us and the Federal Government has decided, in its wisdom, that it is going to control securities regulation and, therefore, if there's action to be done on the bidders' side it really has to be done at the Federal level to close any loopholes that presently exist.

Second, to the extent that we are involved with pension funds, the Federal Government once again has decided under ERISA to preempt State authority, so to the extent that we're going to deal with abuses in the pension area involving the financing of hostile corporate takeovers, it is incumbent upon the Federal Government and Congress to make some changes.

In terms of internal governance, at least over the last 200 years, it's really been the States who have been involved with regulating internal governance. So it seems to me, to the extent that we are talking about defensive abuses, that that really is the responsibility of State government to take some initiative in that area.

It also seems to me that on the private sector there is a response. I think we have to look at the fact that many, many shareholders are increasingly becoming institutional. To the extent that the changes and the abuses that are coming about are affecting institutional investors, I think the institutional investors are large enough and can get themselves organized enough over a period of time as they see their own self-interest being injured, that they will play a major part either in preventing defensive measures which are to their detriment or dealing with corporate raiders which are to their benefit.

So I think there is a combination of forces that ought to be at work here.

Senator **GRAHAM**. My time is almost over and I'd like to ask one additional question.

It's been suggested by both previous panelists and some members of this committee that this is an excessively protective bill relative to current management and imposes inappropriate restraints on the ability of external forces to preempt that current management.

What is your sense of the balance of this as between incumbents and challengers?

Mr. **CELEBREZZE**. Quite to the contrary, I think that what this bill would do in some respects is allow management to go back to the job of managing companies and doing long-term planning and increasing the quality of the product and increasing profits to their shareholders and for the communities that they operate in, and it will perhaps relieve them a little bit of constantly having to look over their shoulder to make sure that the next quarter's profits are good and that they don't make themselves a target of one of these raiders and have to plan defensive measures.

So I think what this bill would do is restore a little bit of the balance that has existed so that management can concentrate on managing and when we want to have a takeover, it's done in some kind of an organized fashion, so that people have time to deliberate and make rational decisions rather than deciding with their feet. I don't think it is protective of current management in any way, but it would let them manage the companies and let the test of their management be evidenced in more traditional ways.

The CHAIRMAN. Thank you, Senator Graham.

Senator Sanford.

Senator SANFORD. Thank you very much, Mr. Chairman.

I especially want to welcome Dan Bell here from North Carolina in his position as a national representative of the North American Securities Administrators' Association. We're pleased to have you and we're certainly pleased to have your interest.

Mr. BELL. Thank you.

Senator SANFORD. I think one of the dangers of drawing this legislation together is that we might inadvertently give rulemaking authority to the SEC that somehow impinges on the States' responsibilities, and I wonder if you have seen any of that or are alert to it or want to comment with a word of caution?

Mr. BELL. I would be more than happy to comment on that.

Yes, we have seen that, particularly under the Williams Act, in which many of the provisions are implemented by rule. That had been used in earlier cases prior to Mite and in the wake of Mite as Federal preemption language of an agency rule of preempting the State's statutory authority and their legislative initiatives.

With regard to the States rights clause in S. 1323, we certainly are very happy and pleased to see it there. We are a little bit concerned that it only goes as far as section 13 and 14 as opposed to the entire title, which causes us concern that the SEC may be able to adopt rules under other sections that could be read as preempting the States as well.

Senator SANFORD. Mr. Celebrezze, I'm delighted to see you. I always feel good and always did feel good when we had a Celebrezze in town.

Mr. CELEBREZZE. Thank you, Senator.

Senator SANFORD. I'd like to ask you and Mr. Geltman—as a matter of fact, I'd like to ask all three of you to comment for this record on something that Mr. Geltman said that is throughout this bill that the Governors' Association supported the provision that provided for expressing a concern for the community, what is the impact on the local community, among other things.

Now this gets at a point that has been made here from time to time by investors, by people who think that raiding is all right, that anything goes, that the only question is how the stockholder is served. And we had an otherwise very distinguished gentleman here who contended that if the stockholders got rich that made it all right.

I'd like to have your feeling about who is involved and who has an interest and who has a legitimate interest in what happens to a corporation. Just the stockholders? Let's start with Mr. Celebrezze.

CONCERN FOR THE COMMUNITY

Mr. CELEBREZZE. Senator Sanford, it goes far beyond the stockholders. I don't think anyone wants to see shareholders suffer, but in Ohio we have had a number of landmark attempts of takeovers—Goodyear, Owens-Corning—going clear back to Mobil-Marathon-U.S. Steel a number of years ago.

What is at stake here is not only corporate management, the corporate research and development effort, but a very real stake is held by the State and by the communities that these corporations exist in.

You take Marathon Oil out of Findlay, OH, and you take away Findlay, OH. In Akron, Goodyear is a very real player in the community affairs of that city. There are thousands of jobs there. Those jobs contribute to the economy of the city of Akron. So there are a lot more parties that have a stake in this whole thing than merely the shareholders and I think we have to recognize that in this modern day and age, that they are related and that everyone has a stake, not only the communities but the economy of the States and the national economy ultimately.

Senator SANFORD. Mr. Edgar?

Mr. EDGAR. Well, again, I agree with the attorney general that everyone has a stake and it's more than just the shareholders. However, I wouldn't go as far as saying that we're going to overrule—Government should overrule the rights of the shareholders, but I think we can make sure because it is such an important matter that has implications on the entire community that the process by which those decisions are made everyone is given ample opportunity to understand the full scope of what a takeover might result in or what management might do in response.

So again, I wouldn't say we take away shareholders' rights, but we make sure that everyone involved in making those decisions understands the full implication. Currently, I don't think that exists. All of us have our horror stories of takeover attempts and people not knowing until it was too late, and I think the thrust of this legislation is to try to make sure that everyone has an equal opportunity and I think fair legislation is what we are all in support of and I think this legislation goes a long way in achieving that.

Senator SANFORD. Mr. Geltman.

Mr. GELTMAN. The reason I think we put in the statement our concern about community impact is not to say that the managers are required to be concerned about more than the corporation and its shareholders, although I think it would certainly be to the country's welfare if they did have concerns about the locations in which they did business, and that it would probably be very good business. But I think our concerns are that a good number of the shareholders are very likely to be local residents who are going to have an interest in what the impact is, and beyond that, the employees have an interest. Some of them may be shareholders and some of them are certainly going to be affected by what happens.

But beyond that, State governments and local governments are also going to play a role. Inevitably, there are going to be dislocations. There are dislocations because of foreign competition. There will be dislocations as a result of takeovers, and there will be dislocations as a result of hostile corporate takeovers. If we have advance notice, then we can begin to deal in a timely fashion with our responsibility to minimize the effects of plant closings, with layoffs, with State programs to aid corporations to cope with the problems that resulted from the transactions that occurred.

Certainly former Governor Graham and former Governor Sanford have had to deal with that, and I think the more information they have had ahead of time, the better able they and their former colleagues were able to deal with that situation.

So to the extent that we can have advance notice, I think the community will be better off, and Governors can cope with whatever happens. There are certainly training programs that are going to have to be provided for workers who will be laid off, assistance programs for the community and provision of other kinds of funding to help the community cope with the problems of dislocation.

Senator **Sanford**. If it's all right, we'll let Mr. Bell put a word or two in.

The **Chairman**. Of course.

Mr. **Bell**. Well, with regard to is the impact beyond shareholders, I think there have been plenty of horror stories that have been described here and in previous hearings that are well documented that the impact I think goes far beyond the shareholders. It certainly involves the community.

As you can appreciate, in North Carolina we certainly have a tender offer waging now with Burlington Industries and I think the community, by and large, in North Carolina would have loved to have had an economic impact report to tell them exactly what assets may potentially be sold off, what jobs could be affected, et cetera. So I think that it does have certainly a community impact.

Senator **Sanford**. Well, thank you very much. As a matter of fact, the Burlington situation apparently is resolved and the raider for his efforts has virtually wrecked the company and converted so much equity to debt that they are going to have to cut back on research and improvements and reduce their competitiveness, and he gets about $100 million from the stockholders for his efforts.

So that's the kind of abuse that we're talking about and it affects far more than just stockholders.

Thank you very much, Mr. Chairman.

The **Chairman**. Gentlemen, thank you very much. Your testimony has just been excellent.

Senator **Graham**. Mr. Chairman.

The **Chairman**. I beg your pardon.

Senator **Graham**. I'd like to ask for any follow-up information or comment that you would care to make. Later this week, this committee will hold a hearing on the specific issue of corporate takeovers in the environment of a corporation either as the acquirer or as the incumbent with a high degree of employee ownership. The questions are: Are there any characteristics that distinguish a highly employee-owned corporation in a takeover situation from any other corporation? If so, what are those characteristics and how should they be treated differently than the treatment afforded to a corporation without a high level of employee ownership?

If you have any comments on that series of inquiries, I would be very interested in receiving them.

The CHAIRMAN. Send me a copy. Thank you, gentlemen, very much for a fine job.

The committee will stand in recess until tomorrow.

[Whereupon, at 12:10 p.m., the hearing was adjourned.]

REGULATING HOSTILE CORPORATE TAKEOVERS

WEDNESDAY, JUNE 24, 1987

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:20 a.m. in room SD-538, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Riegle, Dodd, Graham, Wirth, Garn, Heinz, Armstrong, Hecht, Bond, and Chafee.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. Now we will reconvene for the hearing we have.

Our witnesses on the first panel are John Bachmann, chairman, Securities Industry Association and Mr. Robert Greenhill, managing director, Morgan Stanley & Co.

Gentlemen, I have some remarks I would like to make at the beginning. We welcome your appearance and we know of your distinction and success and knowledge of this industry, but some of us are very concerned about what's going on with takeovers.

I want to read from a statement by, of all people, the Commissioner of Agriculture in Texas, who wrote an article for the New York Times recently and this is what he had to say.

He said:

> Last year there were 4,022 mergers, leveraged buyouts, and takeovers in this country. They soaked up $190 billion in capital. In the last 3 years 9,000 companies changed owners at a cost of nearly half a trillion dollars. For what? Not for new plants, products or jobs, but for paper shuffling for lawyers, accountants, brokers, bankers and big investors. Hundreds of millions of dollars paid in nonproductive fees to achieve nonproductive ends.
>
> An example. Kholberg, Kravis and Roberts, an investment syndicate has engaged in two dozen buyouts since 1979. Last year it bought Beatrice Foods, the largest food conglomerate in America, for $6.1 billion. Beatrice had previously bought Norton Simon for $1.1 billion and Esmart for $2.8 billion. Ten billion dollars changed hands without creating one new job or product. It did make Kholberg, Kravis and Roberts, which couldn't make a biscuit if someone kneaded the dough, the largest food manufacturer in the United States. Having cornered the processing market, this syndicate decided to get into retail sales. It undertook a takeover of Safeway at a price of $4.2 billion, but it didn't use much money. Instead, it leveraged Safeway's assets to pay for the debt. That means that it leveraged stores and careers in thousands of middle class households in the interest of several communities. Nearly 1,000 of the 3,000 Safeway stores are expected to be closed or sold to pay for the deal affecting up to 30,000 employees. Already 8,600 Safeway workers in North Texas have been laid off.
>
> These employees are paying for the good fortune of Kholberg, Kravis and Roberts which paid itself $60 million in fees to handle its own takeover of Safeway and will

soon profit tremendously from the resale of its Safeway stock. The lawyers for the deal made $10 million. So did Morgan Stanley, which acted as a consultant. Even the printer of the documents for the takeover made $3 million. The Dart group which had lost an earlier bid to take over Safeway made $150 million as a kind of consolation prize.

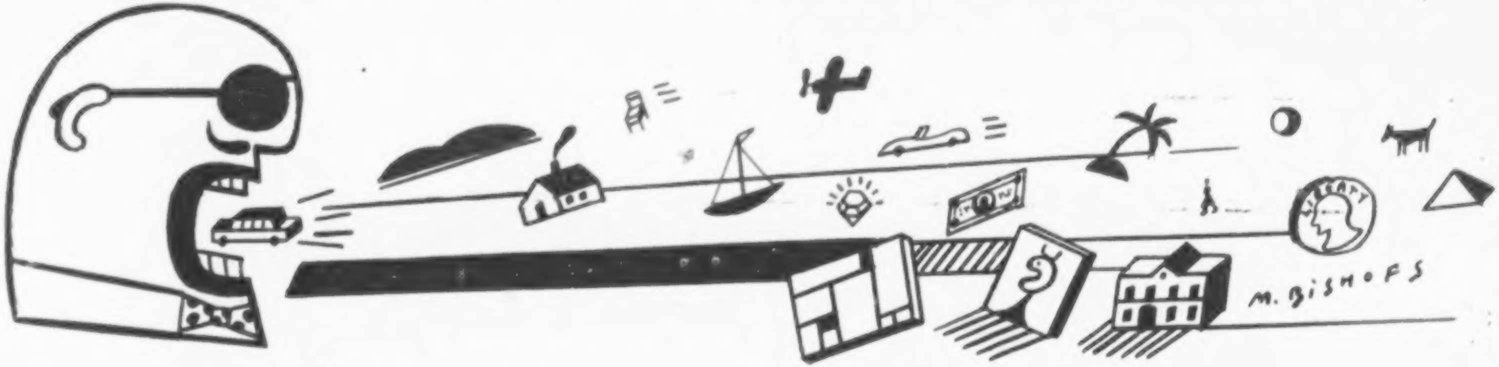
Now major American companies are now put into play by American and foreign raiders whose chief aim is to stick up corporate management, take away the company they manage, strip away its wealth, and get rid of so-called surplus employees. Why?

So the raiders can extract the company's equity base and thereby enrich themselves without regard to what they are doing and to the hopes and dreams of those managers and workers who labored to create that wealth and also without regard to the impact on the communities where the company is located.

The game is made possible because stock prices do not always reflect the breakup value of corporations. The threat of bustup takeovers is leading to a condition in American industry where the equity base of corporations is being dispersed to raiders and current shareholders, leaving the corporation saddled with debt and locking the wherewithal to compete aggressively in our new world marketplace. The current shareholder may get increased wealth in the short run, but at the expense of wounding or killing the goose that lays the golden egg.

[Article from the New York Times follows:]

Where Greed, Unofficially Blessed by Reagan, Has Led



By Jim Hightower

AUSTIN, Tex.

There has been no end of anguish recently about the philosophy of greed that, armed with the unofficial blessing of the Reagan Administration, seems to have invaded a distressingly large number of our institutions, from Wall Street to the electronic ministry.

But what we do not often hear discussed is the dangerous, perhaps even historic, polarization of society it has led to.

- Fifteen years ago, the richest 1 percent of American families held 27 percent of the nation's wealth; today, they are approaching and may soon surpass the 36 percent peak share attained in 1929.
- For the poorest 20 percent of American families, annual incomes (in real dollars) are one-third less than they were 15 years ago.
- In 1981, only four corporate executives took a million dollars or more in annual compensation; last year, 220 chief executives earned more than a million dollars.
- Nearly half of the new jobs created from 1979 to 1985 pay less than a poverty-level income — $180 a week.
- While New York City stock brokers complain about the difficulty of maintaining their life styles on $600,000 a year, one out of five children, two out of five Hispanic children and three out of five black children now live in poverty.

Last year, there were 4,022 mergers, leveraged buyouts and takeovers in this country. They soaked up $190 billion in capital. In the last three years, 9,000 companies changed owners at a cost of nearly half a trillion dollars. For what? Not for new plants, products or jobs, but for paper shuffling, for lawyers, accountants, brokers, bankers and big investors — hundreds of millions of dollars paid in nonproductive fees to achieve nonproductive ends.

An example: Kohlberg, Kravis & Roberts, an investment syndicate, has engaged in two dozen buyouts since 1979. Last year, it bought Beatrice Foods, the largest food conglomerate in America, for $6.1 billion. Beatrice had previously bought Norton-Simon for $1.1 billion and Esmark for $2.8 billion. Ten billion dollars changed hands without creating one new job or product. It did make Kohlberg, Kravis & Roberts, which couldn't make a biscuit if someone kneaded the dough, the largest food manufacturer in the United States.

Having cornered the processing market, this syndicate decided to get into retail sales. It undertook a takeover of Safeway, at a price of $4.2 billion. But it didn't use much money. Instead, it leveraged Safeway's assets to pay for the debt. That means it leveraged stores and careers and thousands of middle-class households and the interests of several communities.

Nearly 1,000 of the 3,000 Safeway stores are expected to be closed or sold to pay for the deal, affecting up to 30,000 employees. Already 8,000 Safeway workers in north Texas have been laid off.

These employees are paying for the good fortune of Kohlberg, Kravis & Roberts, which paid itself $80 million in fees to handle its own takeover of Safeway and will soon profit tremendously from the resale of its Safeway stock. The lawyers for the deal made $10 million.

So did Morgan, Stanley, which acted as a consultant. Even the printer of the documents for the takeover made $3 million. The Dart Group, which had lost an earlier bid to take over Safeway, made $150 million as a kind of consolation prize.

None of this is illegal. But there is a larger danger here, arising from the growing concentration of wealth and power and the squandering of billions of dollars in unproductive activity that does nothing to help the 90 percent of us at the bottom of the economic totem pole.

There is nothing wrong with the pursuit of fame and fortune — indeed, it has helped to make America great. But we cannot allow American gumption to be reduced to a valueless pursuit of self-aggrandizement, as measured by condos and automobiles and Cuisinarts.

This year, we are indulging in self-congratulatory celebration of the 200th anniversary of the Constitution. While reminding ourselves how we have worked to build a great nation, we must also celebrate the prospect that in the next 200 years, outsiders, mavericks and other champions of social justice and economic opportunity will strive to democratize that document.

Any celebration of our democracy must embrace both the Founding Fathers and the work of ordinary people who have joined in common cause. The 1980's have been a decade of regression for the ordinary people. It is time to replace the nation's ethical rudder. □

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im Hightower is commissioner of e Texas Department of Agricul-re

The CHAIRMAN. Beryl Sprinkel, speaking for the Reagan administration, told us yesterday:

> Such corporate control transactions benefit the economy. Historically, corporate managers have had to plan for both the short and long term interest of the company entrusted to them by the shareholders. Now the administration tells us that corporate managers should load the company with debt in order to pay out the equity to shareholders and raiders in the interest of capital allocation.

I ask unanimous consent that the remainder of my statement be printed in the record as if read.

[The complete prepared statement of Chairman Proxmire follows:]

PREPARED STATEMENT OF SENATOR WILLIAM PROXMIRE

This morning we will continue our hearings on various legislative proposals designed to eliminate abuses that have become all too commonplace in tender offers for the control of U.S. corporations.

The Williams Act, which governs such matters, was enacted in 1968 to bring cash tender offers under the supervision of the SEC because shareholders were being denied fair treatment under lightening quick cash tenders not subject to disclosure under SEC law at that time.

Since 1968 the market professionals have found new methods for carrying out their takeover schemes that have made the Williams Act impotent. Shareholders are being abused and the Congressional intent behind the Williams Act is being frustrated.

The gutting of the Williams Act not only has resulted in new shareholder abuses, but also has permitted the whole takeover system to become a game that has reached new heights of absurdity. Major American companies are now "put into play" by American and foreign raiders whose chief aim is to stick-up corporate management, take away the company they manage, strip away its wealth, and get rid of so-called surplus employees. Why? So the raiders can extract the company's equity base and thereby enrich themselves without regard to what they are doing to the hopes and dreams of those managers and workers who labored to create that wealth, and also without regard to the impact on the communities where the company is located.

That is the game. The raiders get wealthy and so do their investment advisers who help them find the likely targets and assist in carrying out the hostile takeover.

The game is made possible because stock prices do not always reflect the break-up value of corporations. The threat of bust-up takeovers is leading to a condition in American industry where the equity base of corporations is being dispersed to raiders and current shareholders—leaving the corporation saddled with debt and lacking the wherewithal to compete aggressively in our new world market place. The current shareholders may get increased wealth in the short run, but at the expense of wounding or killing the goose that lays the golden egg.

Beryl Sprinkel, speaking for the Reagan Administration, told us yesterday such "corporate control transactions" benefit the economy. Historically corporate managers have had to plan for both the short and long term interests of the company entrusted to them by shareholders. Now the Administration tells us corporate managers should load the company with debt in order to pay out the equity to shareholders and raiders in the interest of "capital allocation."

I don't think the Administration is right. Their philosophy on this issue is part and parcel of their overall approach to "live well today and forget about tomorrow." That philosophy has brought us unprecedented budget deficits and an ever growing national debt. It has led us to become the largest debtor nation in the world. An article in today's Washington Post tells us America now has larger foreign debt than "Brazil, Mexico and Argentina combined."

The legislation I and others on this Committee have introduced is designed to stop the hostile takeover game in which wealth is extracted from corporations for the benefit of raiders and their investment banker handmaidens.

I look forward to hearing from today's witnesses so we can get their views on the particulars of the bills now before the Committee so we can move to a rapid markup of this much needed legislation.

The CHAIRMAN. Senator Garn.

OPENING STATEMENT OF SENATOR GARN

Senator GARN. Thank you, Mr. Chairman.

Today's hearing, the second in the current round of hearings on corporate takeovers, will again focus on specific legislative proposals now before the committee.

Since hearings were begun back in 1985 on this issue, we have amassed a considerable record on the subject of corporate takeovers. However, this Senator is still not convinced where all that evidence leads.

The record we have compiled indicates clearly that abuses have occurred on both sides of this issue, committed by management as well as by raiders. The record also clearly points out how vitally important this takeover—or said another way, mergers and acquisitions process is to business formation in the country.

In the United States in 1986, there were 4,024 mergers and acquisitions consummated, worth on the average of about a million dollars each. The 1,822 mergers that reported prices in 1986 had a value in excess of $191 billion. I guess we have to ask the question, why is this market so massive and still growing at a 30-percent clip?

Clearly, this is not due just to the actions of a handful of corporate raiders, investment bankers, or arbitrageurs. The phenomenon is being dictated by the force of the marketplace. Companies are consistently concluding that in many cases acquisitions or takeovers offer the fastest and most cost-effective means of achieving growth strategies. At the same time, there is money available from a variety of lending or investing sources to finance these transactions.

So as I have said before, Congress must not act in a manner that would have a chilling effect on this free and efficient marketplace. I have also stated in the past that abusive takeover practices, defensive as well as offensive, should be remedied.

Some of the proposals now before us would impede the acquisition process and upset the delicate balance between buyers and sellers that Congress worked to create and maintain. The purpose of any legislation should be to protect the rights of shareholders, not to favor one interest group over another.

What the chairman has said in the examples he read from the paper are true, we can look at some gross examples of abuse and enormous amounts of money made with no great benefit to stockholders—I think that is all true, but we don't hear very much about the other side of mergers and acquisitions and the benefit to the economy.

It's not dissimilar with when we talk about high yield bonds. It's amazing to me the number of people that have no objection to high yield bonds at all but are totally opposed to junk bonds. When we're able to put a title on it, it makes an entirely different atmosphere out there and just like high yield bonds have a very definite value to a lot of businesses in this country who otherwise would not be able to finance their businesses, we need to keep that in perspective, recognize the abuses and junk or high yield bonds, and not overreact to that problem where there is a market that is very helpful to the economy. I think that's the approach I have to take is, yes, recognize the abuses that have occurred in mergers and acquisitions, but also recognize that the vast majority of them are probably good for the economy and good for the stockholders.

So as we address this problem, I hope we will keep that balance in mind and try to produce legislation that will prevent the abuses without going far too far and cutting down a very legitimate part of our business structure.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Riegle.

OPENING REMARKS OF SENATOR RIEGLE

Senator RIEGLE. Thank you, Mr. Chairman.

These are two very important witnesses that we have here today and the bill that we have drafted and which now has the cosponsorship of 10 Senators from this committee, which is a very significant showing of consensus thinking, this proposal was developed with great care to try to balance the equation so that we deal with problems that we see but in a fashion that will allow capital to move efficiently and readily to the places where it needs to get, and to keep things balanced as much as possible, both on the side of someone making a tender offer and a company that may wish to fend it off.

So as you comment today—and I have some very specific questions—but as you deliver your testimony, it's very important that you try to identify specific items in the legislation that you either support or think need to be changed or if you think there are things missing that need to be there, but if you could make specific observations about that proposal, that would be very helpful to us.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Heinz.

STATEMENT OF SENATOR JOHN HEINZ

Senator HEINZ. Mr. Chairman, as we continue our hearings on corporate takeovers, I join you in welcoming our distinguished panels of witnesses today. The securities industry, represented by John Bachmann and Robert Greenhill, plays a key role in our capital markets and in the continued restructuring of our economy. The labor community, represented by Laurence Gold, plays a key role in our economy and often feels the impact of that restructuring.

Previous hearings have laid the groundwork for the various legislative proposals before the committee. The basic problem is not hostile takeovers per se. Takeovers can be a useful part of the economic scene. The basic problem is the abuse of the capital markets by a few manipulators who put companies into play for short-term financial gain. Those who lose are the investors who are not privy to the same information and management who are unable to evaluate the factors which must be considered in determining whether a takeover proposal is in the best interest of the corporation.

Today's hearings will focus specifically on the proposals introduced by Senators Proxmire and Riegle, Sanford and D'Amato which identify and address the abuses.

With this is mind, Mr. Chairman, we need to set aside the emotional arguments that surround this issue and be guided by the objectives of our Federal securities laws. They were and still are intended to protect the sanctity of the market. Any reform that this committee undertakes should be done with this in mind.

What does sanctity of the market mean? It does not mean protection of entrenched management through elimination of hostile takeovers. It does not mean permitting the raider to engage in coercive, injurious behavior for financial short-term gain. It means absolute protection of the investor through full and fair disclosure and equal treatment in each and every investment decision.

The sanctity of the market, Mr. Chairman, has become tarnished in recent years. One has only to look at the headlines to know that. I am pleased that we are considering steps to restore the fairness and integrity of the markets which, in turn, will benefit all participants.

The CHAIRMAN. Senator Hecht.

OPENING REMARKS OF SENATOR HECHT

Senator HECHT. Thank you, Mr. Chairman. I enjoyed your opening remarks. The only problem is, you're always on the fence. We never know where you stand. [Laughter.]

The CHAIRMAN. I'll try to make myself clearer in the future, Senator Hecht.

Senator HECHT. Well, let me make myself clear then.

I have always felt the free market was best for America. I think we've got the greatest economy in the world. And since 1982, all these abuses that you have been talking about, the net result is 13 million new jobs have been created. And every time someone makes all this money that you're talking about under our system of income tax, they have to pay taxes on it and these taxes are what allows people like yourself and myself to live under the public trough, the Federal trough.

And until such time as this committee can prove that there are abuses in the market, I think the SEC has done an admirable job and I think that under the present conditions I have full confidence in them and I like the fact that we're giving them more money to help regulate.

Thank you.

The CHAIRMAN. Senator Chafee.

OPENING REMARKS OF SENATOR CHAFEE

Senator CHAFEE. Mr. Chairman, I think there's been plenty of wreckage left behind by these mergers and I think the disclosure and the fairness provisions that are in the legislation that is before this committee are good ones and I hope to hear some constructive suggestions from the witnesses today.

But I don't want to suggest that everything is hunky-dory out there, that everything is fine and there isn't a lot of human and economic wreckage left behind by these folks who have just been making literally billions of dollars without the Nation being improved one iota in many instances.

So I commend those who sponsor the legislation and look forward to working with them on trying to make it even better.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much. We have additional statements from Senators Dixon, Sandford, and Shelby that shall be inserted in the record at this point.

STATEMENT OF SENATOR ALAN DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the committee continues its hearing on S. 1323, the Tender Offer Disclosure and Fairness Act, and other tender offer reform legislation. We have a distinguished group of witnesses before the committee this morning, and I look forward to their testimony.

Tender offer reform is a sensitive area, and I know we must be careful as we legislate in an area with significant implications for our capital markets. I continue to believe, however, that the marketplace is, to some extent, out of balance, and that reform is needed to ensure that the increasing number of seemingly speculatively-motivated tender offers is reined in without eliminating tender offers that do improve the efficiency and performance of the American economy. Unfortunately, too many takeovers these days result not in strengthened corporations, but rather in businesses with less equity and huge debt burdens. I don't understand how that can be good for our economy.

I urge the witnesses before us today, therefore, to work with the committee as we work toward enacting strong and fair reforms. I know these issues are controversial, and I understand the concerns of the securities industry. However, we need to act, and everyone should understand that the committee will act, and will act soon.

STATEMENT OF SENATOR TERRY SANFORD

Senator SANFORD. Mr. Chairman, I again commend you for calling this hearing today to look at corporate takeover legislation from two very important perspectives—that of the investment banking community, which has been so involved in putting these mergers and takeovers together and that of labor, which has watched the devastating effect that many hostile takeovers have had on the average worker whose job is traded away as part of a takeover.

I commend Mr. Greenhill and Mr. Bachmann for their helpful testimony and for their honest assessments that change in our takeover laws are needed. I was pleased to read of the many areas in which they agreed with the provisions put forward in the proposed legislation.

However, as I have said at earlier hearings, I remain concerned that unless we directly address the matter of takeover financing we cannot fully and effectively act against the grossest raider abuses of free market privilege.

In particular, as we hear from representatives of our investment banking firms, I believe we need to examine the question of whether, even if it is shown that takeovers are good for our economy—and I do not believe that there is evidence to support such a conclusion—are the transaction costs associated with these corporate break-ups justified? I read statistics concerning one recent takeover that would indicate that if the fees earned by one investment banking firm were allocated on an hourly basis, we would have individuals receiving tens of thousands of dollars an hour. Given such statistics, I think we must examine just who benefits from these "finance-driven" takeovers, which seem, in many instances, to be motivated solely for the purpose of generating transaction costs.

I welcome Larry Gold today as well and wish to commend the AFL-CIO and other labor groups for the good job they have done in pointing out that takeovers have implications for many constituencies other than just shareholders or management.

Mr. Chairman, I commend you on calling this hearing and look forward to today's testimony.

STATEMENT BY SENATOR RICHARD SHELBY

Senator SHELBY. Mr. Chairman, I want to commend you for your leadership in quickly calling this series of hearings on legislation focusing on corporate takeovers.

You and my other colleagues who have put forth legislative proposals on this complex subject are also to be commended for your efforts.

In the past 10 years, the incidence of corporate takeovers has become much more frequent. Takeovers are no longer merely an access to economies of scale but rather have become a mechanism for seizing enormous personal profits, at the expense of the corporation, shareholders, and ultimately the economy. It is this manipulation that indicates a need for legislative restraint.

As I brought out in my opening statement yesterday, several concerns must be addressed.

First, we must look at the overall effects of merger and acquisition activity on the economy as a whole and on the individual companies and their employees, in particular. It is agreed that takeovers are not always detrimental but may often result in an increase in shareholder wealth, a better allocation of resources, and improved economic efficiency.

It is the hostile takeover, fought tooth and nail by the target corporation, that involves the employment of dubious defensive and offensive tactics that may result in the squandering of economic resources.

In response to the wastefulness and loss of productivity caused by these corporate battles, we must examine the procedural aspects of corporate takeovers. It has been our public policy, through enactment of the Williams Act and the implementation of securities regulations, that neither the bidder nor the target company would be favored.

Today, in light of the lexicon of new tactics in the takeover game, that balance may be somewhat askew. In drafting a legislative response, we must be careful to keep "a level playing field" as our goal.

Furthermore, structural considerations must be addressed. As we are all aware, corporate governance is the province of both the Federal and the State governments.

While it is important to acknowledge the authority of the States to govern their own corporate citizens, particularly in hostile takeover situations, the merits of uniformity in the face of a plethora of State statutes must be considered.

While abuses and anomalies associated with corporate takeovers must be corrected, we must be careful not to impose unnecessary and counterproductive restrictions on either bidders or target corporations that may result in the impairment of capital markets and the national economy.

I welcome our witnesses here today and look forward to your comments on these various legislative proposals.

The CHAIRMAN. Our first witness is Mr. Bachmann. Mr. Bachmann, you are chairman of the Securities Industry Association?

Mr. BACHMANN. Yes, sir.

The CHAIRMAN. We're delighted to have you. Go right ahead, sir.

STATEMENT OF JOHN W. BACHMANN, CHAIRMAN, SECURITIES INDUSTRY ASSOCIATION

Mr. BACHMANN. Good morning. My name is John W. Bachmann. I'm the managing partner of Edward D. Jones & Co. of St. Louis, MO. I am also chairman of the Securities Industry Association and it is in that capacity in which I appear today.

Edward D. Jones & Co. is an investment banking and securities brokerage firm which was established in 1871 and has 1,250 offices in 37 States.

I am here today to comment on S. 1323, the Tender Offer Disclosure and Fairness Act of 1987.

SIA has sought to take a leadership role on insider trading and tender offer reform and in January 1987 established the Trading Practices Committee of SIA, which was headed by Robert F. Shapiro of Wertheim Schroder. It issued a report which included a section on mergers and acquisitions on March 24, 1987. The recommendations of the committee which were adopted by SIA's board of directors were aimed at two goals. First, the protection of the shareholder; and second, a balanced program which assures neutrality between offerors and management. In commenting on this bill, we shall use as our testing device the degree to which the proposals protect shareholders while affording neutrality to both offerors and management.

[The complete prepared statement of John W. Bachmann follows:]

TESTIMONY OF JOHN W. BACHMANN
BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS
June 24, 1987

Good morning. My name is John Bachmann and I am the Managing Partner of Edward D. Jones & Co. of St. Louis, Missouri.[1] I am also the Chairman of the Securities Industry Association and it is this capacity in which I appear today.[2] I am here today to comment on the Tender Offer Disclosure and Fairness Act of 1987.

On March 24th of this year, the Trading Practices Committee of SIA, headed by Robert F. Shapiro of Wertheim Schroder & Co. Inc., issued its report which includes a section on mergers and acquisitions.[3] The recommendations of that committee were all aimed at the protection of the shareholder and a balanced program which assured neutrality between offerors and management. I am pleased to see that the evenhanded approach recommended by our committee is also the aim of this proposed bill. In commenting on this bill, we shall use as our testing device the degree to which the proposals protect shareholders while affording complete neutrality to both offerors and management.

Sec. 3 - Ten-day Window

SIA fully agrees that the ten-day window in Section 13(d) should be closed. The bill proposes a filing within one day after crossing the threshold; SIA had proposed a filing prior to crossing the threshold so that the difference is extremely slight. The bill requires a public announcement before proceeding after the filing is made; SIA had suggested a public announcement prior to crossing the threshold. Again, a very slight difference. SIA does not agree, however, that the threshold needs be lowered from 5% to 3%. The threshold of 5% has never really presented any problem and certainly gives shareholders sufficient forewarning of any attempted takeover. While both 5% and 3% are arbitrary numbers, the lower threshold will result in many additional meaningless reports being filed with the SEC without any compensating regulatory benefit or benefit to shareholders. Large institutional purchases could be captured by the lower threshold and these purchases have nothing to do with attempts to obtain control of a corporation. We would suggest closing the window first and if experience continues to demonstrate a problem, then the threshold can be addressed.

The proposed legislation would require that persons subject to the filing requirements of Section 13(d) disclose: 1) any communications with a third party, regarding an intention to purchase the relevant securities, which took place in the 90 days prior to the filing; and, 2) information relating to the financing of the purchases including the identity of the lenders and the amount of fees paid. These requirements do not supply any information which is helpful to a shareholder and may cause many innocent persons who are not subject to any filing requirements to be included in public records. These filings could also discourage private venture capitalists from participating in a tender offer which would unnecessarily inhibit the ability to put together a financial package. It is unrealistic to make every conversation about all potential deals the subject of some future reporting requirement. This whole section puts a chilling effect on the efforts of an offeror to mount a tender offer and therefore violates the spirit of neutrality which is essential in this process.

Sec. 5 - Enforcement Measures

SIA had called for better enforcement and a broader definition of the "group" in its Report. The proposal to include two or more persons acting in a "consciously parallel manner" as the action of one person for the purposes of reporting is troublesome. The term "consciously parallel manner" is a nebulous one establishing a very amorphous standard. A similar standard has proven to be very difficult in other areas of the law and portends equal mischief if adopted in this law.[4] While we do not have a specific

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[1] Edward D. Jones & Co. is an investment banking and retail broker-dealer founded in 1871 and with 914 domestic offices.

[2] The Securities Industry Association is the trade association representing over 500 securities firms headquartered throughout the United States and Canada. Its members include securities organizations of virtually all types--investment banks, brokers, dealers and mutual fund companies, as well as other firms functioning on the floors of the exchanges. SIA members are active in all exchange markets, in the over-the-counter market and in all phases of corporate and public finance. Collectively, they provide investors with a full spectrum of securities and investment services and account for approximately 90% of the securities business being done in North America.

[3] A copy of this report is appended to this testimony. See Appendix A.

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[4] For some of the problems with "conscious parallelism",

(Footnote continued on next page)

suggestion, a codification of current law which addresses coordinated activities undertaken to evade disclosure, such as parking schemes, should he undertaken. Perhaps the SEC could provide you with expert advice on codification.

Proposed Paragraph 13d(4) would prohibit a tender offer where a purchaser has indicated he is holding the securities for investment purposes, unless the purchaser files six months in advance of the tender offer, a revised disclosure statement indicating the intention to seek control. In today's rapidly changing financial world, six months seems an excessively long period of time. The proposed section does allow for an SEC waiver of the period if material circumstances change, but even obtaining the waiver is time consuming. A suggested period of 30 days would be ample notification to the shareholders of the change of intent.

Sec. 6 - Civil Liability

The availability of a private right of action in this legislation could have a chilling effect on tender offers which could discourage any potential offeror right at the outset. Management would be afforded a potent weapon which could be used as a dilatory tactic capable of destroying the effectiveness of any potential offer. The availability of a private right of action in every instance, even in the case of a technical error, by all "aggrieved persons" promises nothing but endless litigation. This section could give targets the ability to delay bids for months or years. This again unnecessarily tips the scales in favor of management, violates the spirit and tradition of neutrality, and adds nothing of benefit to the shareholders. The goal as we have mentioned should be to eliminate bias on each side, not to create more.

Sec. 7 - Tender Offers

The proposed legislation would require a tender offer to remain open for a minimum of 35 business days. Thirty-five business days is seven calendar weeks. SIA has proposed that the tender offer period be expanded to thirty calendar days. The longer the period that a tender offer is open the more costly the financing for the offeror. This, of course, tips the scales in favor of incumbent management. The shareholder does not need an overly long tender offer period since the single purpose of this period is to allow the shareholder to obtain information concerning the offer, evaluate it and make a decision whether or not to sell. We believe thirty days is

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(Footnote continued from previous page)
please consult the antitrust laws and some cases under the Sherman Act. For example, see Theatre Enterprises, Inc. v. Paramount Film Distribution Corp. 346 U.S. 537, 541 (1954).

more than ample time for any shareholder to make an evaluation concerning the sale of his shares of a company he owns. Seven weeks unnecessarily increase the risks of such a transaction without any substantial compensating benefit to the shareholder. The tender offer period should be as short as feasible while still permitting proper shareholder evaluation of a tender offer.

SIA agrees that in order to prevent "creeping tenders" that acquisitions over a stated maximum should be made pursuant to a tender offer. SIA has suggested a 20% maximum; the bill proposes a 15% maximum. Again, the differences are slight and SIA endorses this approach. It does not appear to us that this provision specifically addresses the practice of "sweeping the street," or asset and stock lock-up arrangements. Without restrictions on these defensive tactics, a management would be free to defend itself against a takeover through a variety of measures which serve to disenfranchise shareholders through dilution or other means. We would endorse restrictions on these practices.

SIA agrees that poison pills and golden parachutes need to be approved by shareholder's votes. However, we would not limit this to schemes adopted during the pendency of a tender offer. Virtually all such plans are abusive and shareholders deserve to have a voice in their adoption. This is true as well for those schemes already put into place without shareholder approval. SIA endorses the elimination of greenmail as an abuse which is utilized by both bidders and management and which diminishes the value of shareholdings.

Sec. 9 - Registration and Regulation of Arbitrageurs

SIA does not oppose the registration of arbitrageurs that are currently unregistered with the SEC. If the purpose of this section is to regulate the unregistered, then an exemption should be provided for registered broker-dealers like the one provided for registered investment companies. Adding another layer of regulation on SEC registered broker-dealers is counterproductive.

Sec. 10 - ERISA Amendment

SIA and its Trading Practices Committee have taken no formal stance on the ERISA provisions in the legislation. Generally speaking, we would prefer to see all of ERISA re-examined as a package, and are leery of tampering with individual provisions solely in a tender offer contest. That position aside, the following specific comments are addressed to the ERISA section.

The ERISA amendment absolves a fiduciary from liability for any decision not to tender securities in a tender offer. This section could give rise to many abuses. It would seem to provide opportunities for management to pressure fiduciaries not to tender stock during a tender offer. This section could work to the detriment of the ERISA beneficiaries by insulating the fiduciaries from attack from their beneficiaries. SIA recognizes the problem of the vulnerability of a fiduciary who fails to tender, but exculpation, while protecting the fiduciary creates other problems which can prove harmful to the beneficiaries. A simple remedy is not easy and SIA has no particular one to offer, but perhaps some provision for a good faith defense on the part of a fiduciary who fails to tender would afford some relief.

It is also of questionable benefit to the beneficiaries of an ERISA plan to limit the use of excess funds as the bill proposes. The provisions are, at a minimum, less than evenhanded since they restrict only bidders. The bill singles out takeovers and proposes special provisions for them. Managers should be obliged to use such excess funds as they are normally for all situations without being saddled with a specialized law focusing on one particular type of situation. It is more desirable to leave the ERISA laws alone than to adjust them solely for the purpose of addressing takeover situations. Tampering with such a delicate set of laws and taking them out of context may result in unexpected and unwanted results.

Sec. 11 - Increased Penalties for Insider Trading, Perjury and Obstruction of Justice

SIA favors the increased penalties for violations of these sections and believes that they will act as a deterrent to any future violations, but perhaps this should be left to insider trading legislation.

Sec. 12 - Role of State Law

Tender offers deal with the purchase and sale of securities in interstate commerce. Shareholders of large public corporations reside in each of the 50 states. A offer to buy shares is certainly a subject matter suitable for the federal securities laws. Such transactions have nothing to do with the internal affairs or governance of corporations which are subject to state laws and regulations. The federal laws should be concerned with adequate disclosure to shareholders giving them ample opportunity to digest the information conveyed to them so that intelligent decisions can be made concerning their investments. The laws should maintain strict neutrality between offerors and management since unfair advantages to either side will work to the detriment of the shareholder. States should not be allowed to interfere with the neutrality that is necessary for the protection of the shareholder in a takeover situation. Any pronouncement by the Congress concerning the federal securities laws should make it clear that neutrality must be maintained between potential acquirers and incumbent managers and that the federal laws preempt any state statute to the contrary. The proposed Section 36 is not in keeping with this spirit. It is also contradictory on its face with the proposals in the same bill

concerning greenmail, poison pills and golden parachutes which, after all, are matters of corporate governance and the internal affairs of a corporation. States should not be allowed to pass laws interfering with the tender offer process which unfairly tip the balance in favor of incumbent management by either unduly prolonging tender offer periods or placing insurmountable obstacles in the way of any potential acquirer. Such laws work to the detriment of the shareholder whose protection should be the primary goal of federal legislation. It has been estimated that shareholders of New York corporations lost $1.2 billion as the result of a New York antitakeover law which is heavily weighted in favor of incumbent management.[5] Section 36 should be removed from the bill since it militates against the best interests of shareholders and because it contradicts on its face with other provisions of this legislation.

I wish to thank the Committee for the opportunity to testify today to express the views of SIA. As stated before, SIA is supportive of any improvements to the tender offer laws which enhance full disclosure for the shareholder while still maintaining strict neutrality between the offeror and management. SIA would be pleased to work with this Committee in any way possible to achieve these ends. Thank you.

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[5] State Regulation of Takeovers and Shareholder Wealth: the Effects of New York's 1985 Takeover Statute by the Bureau of Economics, Federal Trade Commission, March 1987.

APPENDIX A

REPORT BY THE TRADING PRACTICES COMMITTEE
TO THE CHAIRMAN OF THE SIA

For Release:

4 p.m. Eastern Time
Wednesday, March 25, 1987

TABLE OF CONTENTS

PAGE

Executive Summary iii

Background 1

General Observations 1

Specific Recommendations 2

- I Improving Enforcement 3
  - 1. Greater Budget for SEC
    - A. For Staffing
    - B. For Automation
  - 2 Supervision and Surveillance Responsibilities
    - A. SRO Initiatives
    - B. Securities Firms Initiatives
- II Definition of Illegal Behavior 4
  - 1. It Should be Defined
  - 2. Care not to Prohibit Market Activities
  - 3. Rejection of Parity of Information
  - 4. No Vicarious Liability for Employers
- III Mergers and Acquisitions 4
  - 1. Disclosures
    - A. Shut 13(d) Window
    - B. Clarify Control Group
    - C. Stronger 13(d) Penalties
  - 2. Takeovers
    - A. Close Hart-Scott-Rodino Loopholes
    - B. 30 Calendar Day Tender Period
    - C. Prior Shareholder Approval for Greenmail
    - D. Prior Shareholder Approval for Poison Pills
    - E. Limit Lockups
    - F. Tender Offers for above 20% Purchases
    - G. Preemption of State Antitakeover Statutes

IV Discussion of Recommendations 5

1. Improving SEC Enforcement 5
2. SRO Enforcement 6
3. Firms' Enforcement 7
4. Definition of Illegal Behavior 8
5. Shut the 13(d) Window 11
6. Extend and Clarify the 13(d) Group Definition 11
7. Stronger Sanctions for 13(d) 12
8. Close Hart-Scott-Rodino Loopholes 12
9. 30 Calendar Day Tender Offer Period 12
10. Prior Shareholder Approval for Greenmail 13
11. Prior Shareholder Approval for Poison Pill 14
12. Limit Lockup 14
13. Purchases Above 20% Limit Must be by Tender Offer 14
14. Preemption of State Antitakeover Legislation 15

Conclusion 15

EXECUTIVE SUMMARY

This report is made up of four parts: 1) Some General Observations 2) Specific Recommendations 3) Fuller Explanations of the Recommendations 4) Conclusion. The recommendations are divided into those addressing insider trading problems and those addressing the area of tender offers which are two separate issues. Following in bullet format is a brief summary of the Committee's recommendations and observations:

o Insider trading and tender offers are distinctly different issues.

o Insider trading and any breach of confidentiality are condemned.

o It is beneficial to maintain arbitrage and M & A within the same firm.

o Illegal use of non-public material information should be defined - SIA should defer to legal groups and work with them.

o The budget for the SEC should be increased.

o SROs should increase their surveillance and oversight activities.

o Firms should restrict information on a "need-to-know" basis and exert care in the handling of the trading restriction list.

o A special officer with compliance responsibilities should be assigned to the corporate finance area of our firms.

o Firms should require employees to sign confidentiality agreements.

o Shut the 13(d) window by requiring a filing and announcement prior to exceeding the 5% limit.

o Clarify the control group definition for 13(d) purposes.

o Create stronger sanctions for 13(d) violations.

o Close the Hart-Scott-Rodino loopholes.

o Adopt 30 calendar days as minimum tender offer period.

o Prohibit greenmail and poison pills unless there is prior shareholder approval.

o Lockup devices limited to 18 1/2%.

o Require all purchases above 20% to be by tender offer.

o Federal preemption of all state antitakeover statutes.

REPORT BY THE TRADING PRACTICES COMMITTEE
TO THE CHAIRMAN OF THE SIA

Background

At your request I was asked to form a Committee to report back to the Board with recommendations for the Board of Directors' consideration in the areas of insider trading and mergers and acquisitions. A Committee was formed comprised of the following:

Robert F. Shapiro, Chairman
John W. Bachmann
Peter T. Buchanan
Terrence R. Connelly
Richard B. Fisher
Edgar D. Jannotta
Sam Scott Miller
Edward I. O'Brien
Robert E. Rubin

Two taskforces were formed. Messrs. Connelly and Miller worked on improvements in enforcement and compliance and a definition of illegal behavior, while Messrs. Buchanan and Fisher worked on merger and acquisition area recommendations.

General Observations

There has been an unfortunate tendency to treat the subjects of insider trading and takeovers as if they were the same issue. Insider trading and takeovers are distinctly different issues which require separate, independent treatment. Insider trading is essentially an enforcement problem and one which possibly has a need for clearer definition. The takeover issue is an economic one that requires careful evaluation of available data to determine what regulations are necessary for the economic well-being of the country. This report will appropriately treat these issues separately.

The Committee strongly condemns insider trading and any breach of confidentiality by anyone for purposes of personal gain. Such conduct is basically unfair and breaches the boundaries of acceptable moral and ethical conduct. The Committee does not subscribe to the views put forth by certain academics that insider trading should be permitted in order to promote a more efficient marketplace. The risks of loss of investor confidence and also the confidence of market professionals and corporate officers in dealing with each other far outweigh whatever theoretical market efficiency which might be gained.

The Committee feels that there are many benefits to maintaining arbitrage and merger and acquisition activities within the same firm, but at the same time recommends strengthening controls of these functions. In many instances arbitrageurs are used by the merger and acquisition departments to consult on markets, strategies and the structure of securities in order to establish proper pricing mechanisms. If an M & A specialist must talk to other firms for market information there is a risk that improper disclosures by employees of the other firms may take place which cannot be supervised or controlled by the firm handling the merger. Separating arbitrage and M & A will increase problems, not solve them. Also, risk arbitrage has long been recognized as providing a useful risk transference function that contributes to market efficiency. Performance of this function requires the substantial capital most readily available in large firms which will have a multiplicity of departments including a mergers and acquisitions group. Safeguards in the arbitrage area can be established by the Self-Regulztory Organizations ("SROs") or by the firms themselves without severing the function from investment banking firms.

The Committee also decided not to attempt a definition of illegal prohibited activity through the use of non-public material information but the Committee is concerned about the refusal of Congress and the SEC to define clearly what constitutes illegal behavior in an area which does contain uncertainties and about which legal experts differ. The Committee decided to await the results from various groups which are working on the formulation of language to define such illegal conduct with the expectation that if SIA is in agreement with the results, SIA may endorse them.

Specific Recommendations

I shall outline the recommendations of the Committee which are discussed at length later in the Report. The recommendations are as follows:

I

Improving Enforcement

1. Greater budget for the SEC

A. For Staffing - SIA concurs in the SEC's request for additions to staff because of increased trading volume and the increase in market participants.

B. For Automation - There is a need to improve the computerization of the filing of corporate data, since the more efficient the methodology of making public corporate information, the less opportunity there is for insider trading. The SEC should also improve its computer capabilities for assimilating market information provided by the Self-Regulatory Organizations for surveillance purposes.

2. Supervision and Surveillance Responsibility

A. SRO Initiatives - SROs should review their supervisory and oversight mechanisms, but great care should be taken not to unnecessarily increase the burden of member firms, either operationally or legally. Firms already do much in the area of compliance, spending millions each year to detect and prevent violations of law. Nevertheless, firms are exposed to much legal liability because of the nature of the business and the litigiousness of society. SROs should focus on specific problems, rather than promulgating broad rules requiring additional paperwork. They should encourage direct flexible involvement of management in the supervision of business as an alternative to an increase in reports.

B. Securities Firms Initiatives -

1. Securities firms should be more rigorous in restricting sensitive information on a "need-to-know" basis, and handling the firm's trading restrictions list.

2. Firms should designate an officer responsible for compliance to be assigned to the Investment Banking Department who will be responsible for developing and enforcing clear written procedures, appropriate to the particular firm, to control access to and assure security of confidential, market sensitive information.

3. Firms should encourage and protect employees who disclose improper activity of which they may become aware.

4. Firms should develop training presentations to educate employees of the need for confidentiality of market sensitive information.

5. Firms should require employees annually to execute a confidentiality agreement.

II

Definition of Illegal Behavior

1. Criminal use of material non-public information should be defined by Congress to specify conduct that is subject to criminal sanctions. With the defining of illegal behavior by Congress, it will no longer be necessary for the Courts through strained interpretations of what constitutes fraudulent activity under the Securities Acts to continue this process.

2. New legislation should avoid expanding the law in a manner that would preclude or prohibit desirable market activities.

3. Any parity-of-information approach should be avoided because it would seriously impede most securities research thereby greatly affecting the efficiency of the markets.

4. A firm which has reasonable procedures for detecting and preventing violations of securities laws should be exempt from liability for violations by employees who breach these procedures. It should be made clear in any legislation that unless a firm has participated in or is aware of a violation of the law it should not be subject to liability for violations.

III

Mergers and Acquisitions

The following proposals concerning disclosures and takeovers are a balanced program which keeps the needs of shareholders, buyers and management in perspective. Some of the program is aimed at acquirers to insure greater and quicker disclosure. Some is aimed at management to prevent unilateral defensive actions. All are aimed at the protection of the shareholder. To enact only part of the program will destroy the balance and fairness which are its aims.

1. Disclosures

A. Shut the 13(d) window - the 10-day period should be shut by requiring a filing and announcement by an acquirer prior to going over the 5% limit.

B. Extend and clarify the control group definition in Section 13(d) filings.

C. Create stronger sanctions for 13(d) violations.

2. Takeovers

A. Close the Hart-Scott-Rodino Act loopholes - the partnership exemption in this Act should be eliminated and the investment exemption should be clarified to prevent abuse.

B. Establish the minimum offering period for a tender offer at 30 calendar days.

C. Prohibit greenmail payments unless there is prior shareholder approval.

D. Prohibit poison pill provisions unless there is prior shareholder approval.

E. Limit lockups - the issuance of common stock or any equity interest as a lockup device should be limited to 18 1/2%. Similar guidelines for asset lockups should be explored.

F. Require all purchases above 20% of the voting stock of a company to be made by tender offer.

G. There should be explicit federal preemption of state defensive takeover statutes.

IV

Discussion of the Recommendations

1. Improving SEC Enforcement

The SEC's 1988 Budget request of $145,036,000 is a 27% increase over the 1987 appropriation. This request is entirely justified. Since 1981, disclosure filings by issuers with the SEC have increased 35%. The number of registered broker-dealers has increased 57%. The number of registered investment companies and advisers has increased 86% and the number of shares traded on the New York Stock Exchange has increased 186% (because of the large number of transactions by institutions, the number of transactions has increased only 53% during this period).

During the same period, the SEC's budget increased 43% and the SEC has managed to do a very good job with the resources on hand. However, with the constant expansion of the marketplace, the SEC's resources need to expand accordingly. The SEC, since 1981, has increased its enforcement actions by 63%, and has increased its review of issuer filings by 71%. This speaks well for the management of the SEC and certainly is supportive of their reasonable request to increase their current budget by 27%. Whether or not more funds than requested by the SEC are needed is an open question. The Committee suggests that SIA remain flexible on this question. The question is a complex one and we suggest that a special taskforce be appointed to address this sole issue.

According to the SEC, the increase in its budget will permit it to add 181 additional personnel to its staff and will also assist it in bringing on line the Electronic Data Gathering, Analysis and Retrieval System (EDGAR). SIA has never studied the mechanics of the EDGAR system and is not in a position to pass upon its efficacy. However, since the SEC is concerned about illegal activity involving non-public material information, it is axiomatic that the sooner corporate information can be filed and made public, the less opportunity there is for a misuse of such information. Therefore, it is essential that the SEC be encouraged in developing a workable data processing system and that a greater emphasis be placed on the gathering of corporate information as fast as possible. We hope that money spent in the area of computer enhancements for the SEC now will lessen the need for expenditures of money in the enforcement area in the future.

2. SRO Enforcement

The Self-Regulatory Organizations also should increase their surveillance capabilities and work towards enhancing the effectiveness of the Intermarket Surveillance Group. This Group, which is a cooperative effort amongst all SROs to share information concerning trades in the various markets, has already increased the surveillance capabilities of each of its members. All SROs should strive to make this cooperative effort as efficient as possible. SROs should review their rules and regulations and procedures to make certain that every possible effort is being expended to detect illegal activity and to punish it. We note that the New York Stock Exchange recently proposed rules requiring its members to enhance their supervision and inspection of proprietary and employee trading. While such initiatives are to be applauded, the SROs should also approach these subjects with great caution so as not to create additional severe operational and legal difficulties for the member firms. All our members have compliance officers, many of whom were formerly associated with the SEC or SROs. Many firms have elaborate computerized surveillance systems to monitor the firms' business. Our

members spend millions each year to detect and prevent violations of law. Care must be taken not to impede the ongoing compliance efforts of firms through unnecessary paper work.

The securities business is done orally, usually over the telephone. Hundreds of millions of shares are traded each day on this basis. There are layers of federal and state laws dealing with this business as well as regulations issued by federal and state agencies and the SROs. The securities business is a highly technical one and fraught with potential liability. Care must be exercised by SROs in adopting rules to avoid unnecessarily increasing the potential for such liability.

3. Securities Firms Enforcement

All of our members have compliance procedures and the ability to implement them. Recognizing this, the Committee nevertheless recommends that an officer responsible for compliance be assigned to the corporate finance business of firms. This officer should have an appropriate background and standing to be capable of monitoring the sophisticated business deals generated within corporate finance departments. This officer should be charged with the responsibility of vigorously monitoring the firm's restricted trading procedures and he should be able to control access to and assure security of confidential market sensitive information. Firms should be particularly careful about the dissemination of such sensitive information and the manner in which such information is maintained and disposed of. Security specialists should review such procedures to make them as efficient as possible and to heighten awareness of the potentials for theft. As a model, firms should review the security procedures adopted by their cashiering departments for the protection of certificates and money, to see what can be adapted for use in the corporate finance departments.

It is important that this officer be given sufficient authority and recognition to accomplish the mission assigned to him. There should be an adequate protection provided for employees to report to such officer or to management any improper activity of which the employee may become aware. Manufacturing firms develop elaborate procedures to protect the confidentiality surrounding new products or new models. Securities firms should apply the same type of planning and thinking to the preservation of market sensitive information entrusted to their care.

In addition to all this, it is essential to educate and train all personnel concerning the necessity to maintain confidentiality. Education is the most important tool available to a firm in its attempts to prevent violations of laws and regulations. Firms should take every opportunity to make certain that those who are in particularly sensitive areas understand fully their obligations to be careful in the handling of sensitive information and also thw necessity of not betraying the confidence which the firm and its clients have placed in them. Along this line, we suggest that employees on an annual basis be required to execute a confidentiality agreement. This need be only a simple statement in which the employee agrees not to divulge confidential information or to use it for personal gain. This will reinforce the importance of preserving confidential information and will remind the employee of his obligations to protect and preserve market sensitive information.

4. Definition of Illegal Behavior

The Committee recommends that SIA work with other groups to obtain a definition of what constitutes illegal behavior in the use of material, non-public information. At the present time, the SEC has used Section 10(b) and Rule 10b-5,[1] to pursue violations involving non-public material information. These were drafted rather broadly to permit the SEC to punish any fraudulent activity involved in the purchase and sale of a security. While 10b-5 may be clear at its core it becomes fuzzy when its outer edges are approached.

To prove that a fraud has been committed under Rule 10b-5, it is necessary to show that the accused acted with scienter, [2] that is, the defendant must be shown to have knowingly given false information to or withheld true information from the other party to the transaction, that the information was material, [3] that the other party relied on the defendant and that this reliance [4] caused [5] damage to the other party. Even though the use of the fraud theory places a great strain on the government in cases involving non-public material information, this theory has its easiest

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[1] §10(b) of the Securities and Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. §78j(b); Rule 10b-5 17 CFR §240.10b-5.

[2] Ernst & Ernst v Hochfelder 425 U.S. 185 (1976).

[3] TSC Industries Inc. v Northway Inc. 426 U.S. 438 (1976).

[4] Santa Fe Industries Inc. v Green 430 U.S. 462 (1977).

[5] Affiliated Ute Citizens v United States 406 U.S. 128 (1972).

application when applied to "pure" insider trading. Quite obviously if an officer, director or someone else who occupies a position of trust and confidence to a corporation acquires material, non-public information about the company and trades upon it, he does so to the detriment of the existing shareholders to whom he owes a duty. Rule 10b-5 can readily be used in such a case.

The problem of using 10b-5 in cases not involving pure insider trading plagued the government in two of the most important cases involving non-public material information. The first of these was the Chiarella case.[6] Chiarella worked for a financial printer and deciphered the identity of five public companies which were to be targets of acquisitions. He then traded in the market and made a profit of approximately $30,000. The Supreme Court held that Chiarella owed no fiduciary duty to the people who were selling in an impersonal market at the same time he was purchasing the securities. He neither misled the sellers nor owed them any fiduciary duty. The Court characterized the SEC's theory as a "novel twist" of the common law and the Court showed an aversion for novel applications of Rule 10b-5 in addressing market problems. The Court concluded, "a judicial holding that certain undefined activities generally are prohibited by Section 10(b) would raise questions whether either criminal or civil defendants would be given fair notice that they have engaged in illegal activity."[7]

The second case was the Dirks case.[8] This case involved an investment analyst at a brokerage firm who received a tip from a former officer of Equity Funding that a massive fraud had taken place greatly inflating the price of its securities. After verifying the facts, Dirks notified a number of his institutional clients of this information and they sold their securities before the fraud became publicly known. The Supreme Court held that Dirks could only be liable if he had received information from an insider who had breached his fiduciary duty to the shareholders for his own benefit and disclosed information to a tipee who knows or should have known that there has been a breach.

The Chiarella and Dirks cases greatly inhibited the SEC's ability to bring actions against persons based upon

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[6] 445 U.S. 222 (1980).

[7] 445 U.S. at 235 n.20.

[8] 463 U.S. 646 (1983).

The CHAIRMAN. Thank you very, very much, Mr. Bachmann.

Mr. Greenhill, I should tell you, Mr. Bachmann was well within his 10 minutes. I should tell you we have a 10 minute time limit. Go right ahead.

STATEMENT OF ROBERT F. GREENHILL, MANAGING DIRECTOR, MORGAN STANLEY & CO., INC.

Mr. GREENHILL. Mr. Chairman, members of the committee, I'm Bob Greenhill, the managing director of Morgan Stanley & Co. I am appearing here today on behalf of the Capital Markets Group, which consists of First Boston Corp., Goldman Sachs & Co., and Morgan Stanley & Co.

With your permission, I would like my full statement to appear in the hearing record and I am prepared to summarize very briefly.

The CHAIRMAN. Without objection, your statement will be printed in full in the hearing record.

Mr. GREENHILL. Thank you.

We are grateful for the opportunity to present our views on the proposed revision of the Federal laws dealing with tender offers. We realize that a number of bills have been introduced by different Senators and we will talk generally about the issues. But our remarks today will concentrate on S. 1323, since we are told by staff that it will likely be the vehicle that will be considered by the committee to achieve tender offer reform. I am ready, however, to answer questions by members of the committee on issues not covered in this bill.

The Capital Markets Group comes to this issue convinced that legislation to revise and update the tender offer and takeover laws is needed. Indeed, I had the privilege of serving, as did representatives of the other two firms, on the SEC advisory committee that recommended amendments to the Williams Act in 1983.

LEGISLATION IS NEEDED

While we certainly recognize that legislation is needed, we would argue that there is an overarching principle that should guide the legislation. It should ensure fairness and full disclosure in tender offer and takeover contests without bringing the Federal Government down on either side of a transaction, whether friendly or hostile. This adherence to a fair, impartial system of Federal regulation was the aim of the Williams Act and should remain the aim of our new Federal legislation.

Rather than detail all that we would include in legislation, with the consent of the committee, I would like to include at the end of my statement the full position paper of the Capital Markets Group, a paper that has been available to the majority and minority staffs for some weeks.

The CHAIRMAN. We appreciate that. That will be printed in the record.

Mr. GREENHILL. While we commend the committee for moving in this area in which action is overdue, we must acknowledge with regret serious differences with the approach taken in S. 1323. Those differences arise from our conviction that the legislation fails to meet the basic test of fairness and balance in three significant areas.

First, the bill provides extreme and unnecessary authority to the States to overrule Federal securities laws. We are already at risk in this area because of the Supreme Court decision in the *CTS* case and we believe that S. 1323 moves in precisely the wrong direction. Rather than give more power to the States, we urge the committee to enact legislation that specifically and affirmatively overturns the *CTS* decision and establishes the supremacy of Federal securities law.

We find it difficult to understand why more than 50 years after the Securities and Exchange Act of 1934 was passed in the wake of the crash of 1929, that this committee would want to move to cede its responsibility to the States. We are puzzled why the committee most aware of the national, indeed international, nature of the securities markets would use the guise of State-chartering of corporations to undermine Federal authority and set in place varying State laws that not only make us less competitive but leave investors at the mercy of 50 different State legislatures.

Unless the Congress is willing to assert its proper role in these matters, we fear that not only will the tender offer and takeover process be tilted dangerously at the whim of State legislatures, but that a far more serious step will have been taken. If the States' right to charter corporations is sufficient cause to overrule Federal securities law in the areas of tender offers and takeovers, it is a small step to further usurption of your jurisdiction.

Second, the bill's provisions that claim to prevent abusive tactics of the targets of takeovers simply do not meet the purported objective. It is wholly inadequate to limit the right of directors to impose poison pills and other defensive tactics only after a tender offer has been made. This provides broad license to companies to adopt abusive defensive tactics in anticipation of possible future fights without any consideration of the wishes of shareholders. The managers of 430 companies have already adopted poison pills, the overwhelming majority without shareholder action.

If the committee wants to achieve balance, then it is necessary to ban defensive tactics that have not been submitted to shareholders for a vote. Anything less is an open invitation for entrenched managers to ignore the wishes of shareholders in defense of their own jobs. We regard the banning of defensive tactics other than those approved by shareholders as a minimum test of fairness and a minimum condition for our support of the legislation.

Third, the legislation establishes a private right of action for any party possibly aggrieved in a takeover fight. This is a litigator's dream come true, but we believe it's bad law. It tilts the playing field improperly to the side of the defenders since the litigation it invites could readily be used to stop transactions through delay in courts.

What sounds good will be bad in practice. If a potential acquirer is conducting its affairs in bad faith, the SEC should be empowered to take necessary action and should have adequate authority to seek just remedies. Sending opponents of a given transaction an engraved invitation to use the courtroom rather than the marketplace to resolve these matters is creative but its effect would be immense and destructive of the market. This provision should be rejected by the committee.

Mr. Chairman, members of the committee, I am sensitive to the fact that my concentration on what we view as three main failings in the legislation might be misinterpreted as total opposition to action. I want to reiterate that the Capital Markets Group favors legislation in this area and sees much in it that we can support. We have minor or technical differences with some provisions. With others we have differences over timing but not in principle.

Let me just say that the issue of timing itself is quite important. Actions that delay the completion of tender offers work to the benefit of management by raising the cost of transactions and permitting the adoption of further defenses. To slow the process is not a neutral act but one in favor of entrenched management often at high cost to shareholders. My full statement addresses these matters in detail, but the point with which I want to conclude is that we hope the committee will act to make the tender offer and takeover process work better with greater fairness and disclosure. We hope the committee will adhere to long established rules of balance and neutrality on specific transactions. Some of the legislation we have seen does this. We must conclude that S. 1323 does not.

I would be happy to answer any relevant questions.

[The complete prepared statement of Robert F. Greenhill follows:]

non-public material information. To overcome this, it did two things. In the tender offer area, it issued Rule 14e-3, which makes it a fraud for anyone obtaining material, non-public information about a tender offer to use it for personal gain.[9] There is some doubt concerning the legality of this rule and whether it would be upheld by the Supreme Court if tested. The Schreiber case has been read to cast doubt upon its validity.[10]

The SEC also developed what has been called the "misappropriation theory". This theory was born out of a necessity to counteract the Chiarella case in an effort to supply a breach of fiduciary duty which Chiarella requires in order to obtain a conviction for trading on non-public material information. The SEC proposed that if an employee breached his duty to his employer by misappropriating confidential information, this would supply the necessary ingredient. There are questions raised about this theory by the Dirks decision, which held that in order for the trading to be prohibited there must be "a specific relationship between the shareholders and the individual trading on inside information".[11] The misappropriation theory has been approved in some lower courts, particularly in the Second Circuit in the Materia case,[12] and the Reed case. [13] At present, there is a case before the Supreme Court, the Carpenter case, which involves a Wall Street Journal reporter that will test the validity of the misappropriation theory. [14]

As can be seen from the above, the law is in a state of flux and is not entirely clear as to what constitutes violations of the fraud sections of the securities laws. It is for this reason that the Committee has suggested that this issue be taken away from a case-by-case testing of the outer limits of Rule 10b-5 and clarified by the passage of a law which prohibits certain specific conduct. SIA should cooperate

with all groups which are attempting such a definition and make certain that harmful inadvertent results do not occur. Along this line, the Committee cautions that such legislation should avoid expanding the law in a manner that would preclude or inhibit desirable market activities. The legislation should not attempt to establish a parity of information standard, which the Supreme Court rejected in the Chiarella and Dirks cases, and which could immobilize many valuable professional market activities which contribute to the liquidity and depth of the securities markets. Care must also be taken not to expose our members to vicarious liability simply because employees engage in prohibited activity. Firms should not be held liable unless they partake in the prohibited activity or are aware of the violation taking place. Firms should be able to avoid liability by demonstrating that they have in place adequate procedures to prevent violations of the illegal activity, and that these procedures are carried out.

5. Shut the 13(d) Window

Section 13(d) requires that anyone who acquires directly or indirectly more than 5% of any equity security shall file within 10 days after such acquisition a notice with the SEC.[15] The Committee suggests that the time period is too long and in fact gives the acquirer 10 days to purchase additional shares before filing the necessary form. To correct this, the Committee suggests that this section of the Act be changed to require a purchaser to file with the SEC and to make an announcement prior to exceeding the 5% limit. This means that the acquirer could not go over the 5% limitation until such time as the proper form had been filed with the SEC and a public announcement made by the acquirer. This will make certain that acquirers accumulating over 5% will not do so without public knowledge. Any changes in an acquirer's position should be reported promptly.

6. Extend and Clarify the Group Definition in 13(d) Filing

Rule 13d-3 at present spells out the determinations of what constitutes beneficial ownership for purposes of filing under Section 13(d). Although the language used, particularly in paragraph (b) of this rule is far reaching, the Committee feels that some further definition of the control group is needed to ensure that there is appropriate disclosure of concerted or coordinated activities. The Committee recommends

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9/ 17 C.F.R. §240.14e-3, (1985).

10/ Schreiber v Burlington Northern Inc., et al. 105 S.Ct. 2458 (1985).

11/ 463 U.S. at 656.

12/ Securities and Exchange Commission v Materia 745 F.2d 197 (2d Cir. 1984).

13/ United States v Reed 601 F.Supp. 685 (S.D.N.Y. 1985).

14/ United States v Carpenter 791 F.2d 1024 (2d.Cir. 1986).

15/ §13(d)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78m(d)(1).

that this rule be examined closely so that all possible arrangements for warehousing or other similar strategies be included within its prohibitions. Care must be taken that any expansion not apply to anyone acting purely as an agent for the execution of purchase orders.

7. Create Stronger Sanctions for 13(d) Violations

While the Exchange Act provides for fines and jail sentences for violations of any provision of the Act, there is nothing specific in the Act for violations of the filing requirements of 13(d). It is recommended that clear and strong sanctions are needed for 13(d) violations, particularly to include those people who have misrepresented their purposes in buying shares (for example, someone who is really seeking control but who purports to be buying for investment). Sanctions should be made to apply not only to the person who is deemed to be the beneficial owner of securities under Rule 13d-3, but also to all those who cooperate in any coordinated warehousing scheme.

8. Close the Hart-Scott-Rodino Loopholes

The Hart-Scott-Rodino Act requires a notification to be filed with the Federal Trade Commission and the Antitrust Division of the Department of Justice when 15% or more of the voting securities are acquired.16/ There are a number of exemptions from the filing provisions provided in the Act, most important of which are partnerships and acquisitions for investment purposes.17/ The Committee believes that these exemptions open up loopholes which can be used to defeat the purposes of this Act. The Committee recommends the total removal of the partnership exemption and also recommends that the investment exemption be examined with a view towards clarification.

9. Establish the Minimum Offering Period for Tender Offers at 30 Calendar Days

The current business day calculation used for the establishment of the minimum offering period for tender offers is cumbersome.18/ The use of calendar days is far more readily understood by the investing public and is much easier

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16/ 15 U.S.C. §18a et seq.

17/ 15 U.S.C. §18a(c).

18/ 17 C.F.R. §240.14e-1(a).

to use. Thirty calendar days is ample time for a shareholder to react to a tender offer. Indeed, in a contested offer, if the price is changed, which often happens, the period for shareholder action is automatically extended.19/ A longer period also increases the elements of risk involved in the transaction considerably. The establishment of any longer minimum offering period would only be a substitute for the quashing of the commencement of takeovers. This would unnecessarily tip the balance in favor of the incumbent management and would not be in keeping with the spirit of the Williams Act, which aims at a neutral stance between tender offerers and incumbent management.20/ The sponsor of the Act made this point clearly: "We have taken extreme care to avoid tipping the sales either in favor of management or in favor of the person making the takeover bids. S. 510 [the Senate Bill which became the Williams Act] is designed solely to require full and fair disclosure for the benefit of investors."21/

As recently as 1985 the U.S. Supreme Court had occasion to address this question. Its unanimous decision could not be clearer: "The expressed legislative intent was to preserve a neutral setting in which the contenders could fully present their arguments .... Congress' consistent emphasis on disclosure persuades us that it intended takeover contests to be addressed to shareholders."22/

10. Prohibit Greenmail Payments Unless There is Prior Shareholder Approval

At the present time, the ability of management to buy securities from a shareholder to avoid a hostile takeover bid depends upon the law of the state in which the corporation is incorporated. Whether or not management's action in purchasing the securities is proper will be determined in state court if management is challenged by application of the "business judgment" rule. State courts give considerable latitude under the "business judgment" rule to management, which in effect removes the shareholder from the process of deciding whether or not greenmail should be paid. It is recommended that the federal securities laws be amended to require that all

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19/ 17 C.F.R. §240.14e-1(b).

20/ 15 U.S.C. §§ 78m(d), 78m(e) and 78n(d-f).

21/ 113 Cong. Rec. 24664 (1967) (Remarks of Sen. Williams).

22/ Schreiber v Burlington Northern, Inc. 105 S.Ct. 2458, 2463, 2465, (1985).

purchases by the corporation at above-market prices and any other greenmail payments be approved in advance by a majority vote of the shareholders. This would return the control over such matters to the true owners of the corporation -- the shareholders.

11. Prohibit Poison Pill Provision Unless There is Prior Shareholder Approval

The same reasoning which was applied to greenmail is also applicable to the issue of poison pill provisions. At the present time, under the business judgment rule, it is possible for management to adopt such provisions without the necessity of obtaining approval of the shareholders. The Committee recommends that the federal securities laws be amended to provide that poison pill provisions can only be adopted by a corporation if the true owners - the shareholders - so agree in advance by a majority vote. This will assure uniformity in the tender offer area and will protect all shareholders.

12. Limit Lockups

The issuance of common stock or any equity interest as a lockup device for a bidder should be limited to 18 1/2% of the common stock of the issuer. Similar guidelines for asset lockups should be explored. The New York Stock Exchange's Listed Company Manual requires shareholder approval where present or potential issuances of common stock or securities convertible into common stock would result in an increase of outstanding stock of 18 1/2% or more. The Committee feels there should be provisions in the law which apply this rule to all corporations, not just those listed on the NYSE.

13. Require All Purchases Above 20% of the Voting Stock of a Company to be Made by Tender Offer

The philosophy behind the Williams Act is based upon two elements: neutrality as between bidders and targets and disclosure to shareholders. Both these goals are frustrated by creeping tender offers. In furtherence of this philosophy, the Committee recommends that once an acquirer accumulates 20% of the stock, all purchases above that level be made through a tender offer to all shareholders. This requires an amendment to the federal securities laws to control not only creeping tenders but also the possibility of open market "sweeps". Such legislation will protect the shareholder and ensure that he will be a participant in any effort to change control of the corporation. Of course certain exceptions will be necessary: such as market making, purchases that do not raise shareholder concerns, and other matters which may be pertinent.

14. There Should be an Explicit Federal Preemption of State Defensive Takeover Statutes.

To accommodate local incumbent managements of corporations, several states have adopted antitakeover statutes. These statutes unfairly tip the balance in any tender offer situation in favor of incumbent management and thereby frustrate the policy of neutrality established by the federal government in the Williams Act. The Congress should amend the federal securities laws to make it clear that neutrality must be maintained between a potential acquirer and incumbent management, and that the federal laws preempt any state statute to the contrary. The ultimate loser as the result of these antitakeover statutes is the shareholder. These statutes do not even give the shareholder an opportunity to indicate his choice between the tender offerer and the incumbent management, since the state antitakeover laws permit management to stifle and all but eliminate any hostile takeover bid. The uncertainty concerning the constitutionality of these state antitakeover laws has created much litigation to the detriment of the shareholder, who must ultimately bear the costs of such legal actions. To protect the interest of the shareholder and also to maintain the element of fairness and neutrality in the tender offer process, it is necessary for Congress to state as clearly as possible that in the area of tender offers federal law preempts state law.

CONCLUSION

This concludes our report to the Directors of SIA. We believe this is a balanced package which keeps the interests of shareholders, buyers, sellers, management and offerors in perspective. The Committee is appalled by the acts of members of the securities industry who have betrayed the trust bestowed on them not only by their firms but by their clients. That a number of these very difficult cases have been uncovered and brought to justice is indicative of the fine work that the SEC, in cooperation with the Self-Regulatory Organizations and the securities firms, have accomplished in protecting the integrity of the securities markets. We believe it is our responsibility as securities professionals to assure the public of a system which is perceived to be fair and responsible. We hope the work this Committee has done and the recommendations it has made will contribute towards this objective.

Respectfully submitted,

Robert F. Shapiro
Chairman

Dated: March 24, 1987

STATEMENT OF ROBERT F. GREENHILL
BEFORE THE SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE

JUNE 24, 1987

I. INTRODUCTION

Mr. Chairman and Members of the Committee, my name is Robert F. Greenhill. I am pleased to have this opportunity to appear before you today on behalf of the Capital Markets Group -- First Boston Corporation, Goldman Sachs & Co., and Morgan Stanley & Co. -- to express our views on S. 1323, "The Tender Offer Disclosure and Fairness Act of 1987." We realize that there are a number of other bills on this subject which have been introduced, many by members of this Committee. However, we are focusing our specific comments on S. 1323 because we understand that it is likely to be the markup vehicle.

The Capital Markets Group's members are investment banking firms which play a major role in representing corporations in mergers and acquisitions. We represent both bidders and targets in contests for corporate control. I am a Managing Director of Morgan Stanley, and head of the firm's investment banking division. I have worked in the securities industry for the past twenty-five years, and have been active in the mergers and acquisitions area since 1970. I also served on the SEC's Advisory Committee on Tender Offers in 1983.

The Capital Markets Group very much appreciates the opportunity we have had to meet with your staff before and since the introduction of S. 1323. They have been generous in giving us time to outline our views.

Capital Markets Group favors tender offer reform legislation. Each member of the Group was represented on the SEC's Advisory Committee on Tender Offers in 1983, which issued a report suggesting numerous improvements to the Williams Act. The guiding principle of that Act remains sound -- to protect investors through disclosure while maintaining a level playing field which favors neither bidders nor the managers of companies subject to tender offers. The Act needs to be improved because the securities markets have changed dramatically in the past few years as a result of technological and other developments, and abusive tactics have been developed on both sides, by bidders and targets, which need to be curbed.

We favor a balanced package of reforms. Bidders should be prohibited from evading Section 13(d)'s disclosure requirements, seeking greenmail, and making end-runs around the Williams Act by means of unconventional tender offers and market sweeps. Target company managers should be prohibited from engaging in defensive tactics like poison pills, golden parachutes, and lock-up defenses, without their shareholders' approval. The tactics of both sides are undermining investor confidence in the integrity of corporate control contests. We believe that a statute can be crafted which provides for a fair and orderly process.

We have a number of concerns, however, with S. 1323. First, and foremost, we are troubled by the provision that would effectively give states the power to establish their own individual tender offer laws under the guise of controlling the internal affairs of corporations. If the states are to be free to establish their own minimum offering periods and other rules regulating takeover offers, then there is little point in attempting to craft specific requirements to ensure a level playing field. The states would quickly preempt any federal requirements that were not to their liking, with no regard for the harm that would be inflicted on shareholders.

We are also troubled that the bill would go far beyond prohibiting specific abuses and make sweeping changes that could do damage to a free and open capital market system. The need to curb specific abuses is apparent. However, there is no empirical support for many of the changes proposed by the bill. Indeed, to the contrary, dozens of studies have shown that tender offers may be beneficial to shareholders who receive them and also to the economy in general. Nevertheless, the bill restricts all tender offers in ways which appear to abandon the principle of neutrality and decisively tip the balance in favor of the incumbent managers of our nation's publicly-held corporations to the ultimate detriment of investors and the markets in general. The goal should be to stop the abusive behavior without damaging the markets which are the mainstays of our economy.

Our capital markets have long been regarded as the best, most efficient, and fairest in the world. They have flourished in a free and open regulatory environment. The laws have permitted the marketplace to allocate and reallocate capital, without unnecessary restrictions, based upon investor decisions. This has

resulted in a vast flow of capital into our markets from both domestic and foreign investors attracted by the opportunity to profit in markets which are honest and free from unnecessary restrictions. This has enabled American corporations to raise capital readily for productive uses and produced vast numbers of jobs for American workers.

Our regulation of mergers and acquisitions has likewise been based upon the philosophy that a free and open market for corporate control is in our national interest. Congress has wisely remained neutral in its approach toward mergers, acquisitions, and corporate restructuring. It has allowed investors, and not the government, to determine which mergers, acquisitions, and reorganizations are good and which are bad.

This neutral approach has been beneficial to investors and the economy as a whole. The market for corporate control has provided investors with an opportunity to obtain full value for their shares, and served as a stimulus for restructuring in tired industries which are no longer able to compete, on a business as usual basis, in a world economy.

The time has come for Congress to adopt reform legislation, but it must be carefully tailored on an even-handed basis so that legitimate offers can reach and be fairly judged by investors. We must remain mindful that it is not only American industry which is today facing worldwide competition. The American securities markets are also facing stiff competition from Tokyo, London, and other world markets. The major world markets are being linked by modern technology into one global marketplace, and competition for business and capital is becoming intense. This is producing a remarkable increase in opportunities for investors to ignore national boundaries and to invest in securities essentially any place in the world. We must therefore be hesitant to add unnecessary restrictions which may have the effect of driving trading and capital to other less restricted markets. If the flow of capital into our markets were restricted, the American economy would, in the long run, be the loser.

II. COMMENTS ON S. 1323

While S. 1323, the "Tender Offer Disclosure and Fairness Act," has the appearance of neutrality, in our opinion it would tilt the balance in favor of incumbent managers and stifle legitimate tender offers. The bill appears to subject tender offers, even those which are entirely fair and fully disclosed, to what could be endless private litigation in virtually every case and give states almost a blank check to adopt anti-takeover legislation.

The following are our section-by-section comments on the bill:

A. Section 3. 10-Day Window; Contents of Report. Section 3 of the bill would reduce the current ten-day window to one day and require greater Section 13(d) disclosure. We agree with the proposed reduction of the ten-day window and concur with the concept of greater disclosure. Indeed, we believe that the ten-day window should be eliminated completely by requiring a filing and public disclosure before an investor crosses a five-percent threshold. We are concerned, however, with the manner in which the section would operate. The approach suggested may tend to obscure rather than reveal information to investors.

First, we believe the reporting threshold should remain at five percent. Given the fact that the bill essentially eliminates the ten-day window and prohibits greenmail, we do not believe that there is any compelling reason to lower the reporting threshold from its current five-percent level. Lowering the threshold would produce a flood of additional filings, increase the burden on the SEC, and add new costs to investing in U.S. equity securities for thousands of investors who have no intention of seeking control. The SEC received over 15,000 Section 13(d) filings in fiscal 1986, and this could be expected to double or triple under a lower threshold. The increased filings could only serve to conceal the truly important filings.

Our view on this subject is supported by a detailed study conducted by the SEC in 1980.[1] The SEC found that the increased burdens of a lower threshold would outweigh any benefits, and its conclusion still remains unchallenged today. We know of no study suggesting that a lower threshold would increase investor protection, let alone justify the additional costs and burdens a lower threshold would create.

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[1] Report of the SEC on Beneficial Ownership Reporting Requirements Pursuant to Section 13(h) of the Securities Exchange Act of 1934, 96th Cong., 2d Sess. (July 1980).

We suggest that Congress take one step at a time. If closing the ten-day window proves to be inadequate, Congress can consider lowering the five-percent threshold. To move forward with this second step at this time, with no proven need or justification, runs the risk of imposing costly and burdensome restrictions on investments in U.S. equity securities which may be entirely unnecessary.

Second, we have a concern with the practical effect of the provision which would require persons filing Schedule 13Ds to check either an "investment" or "control" intent box on the form. This provision is designed to deal with a legitimate problem -- evasive Schedule 13D disclosures. The definition of a "control" intent is so broad, however, that investors may have no choice but to check the "control" intent box. The definition of control includes not only an intent to acquire or "influence" the control of the issuer directly but also to engage in any conduct which would have the "effect of permitting any other person to acquire or influence such control ... ." Any shareholder who intends to exercise independent judgment in voting his shares could have a control intent under this broad standard. The effect of this provision might be that everyone would simply check the control intent box, obscuring the truly significant Schedule 13Ds.

B. Section 4. Time for Filing Amendments. The establishment of a specific time for filing Schedule 13D amendments is an appropriate improvement in the law.

C. Section 5. Enforcement Measures. Section 5 attempts, with good reason, to provide remedies for two problems -- the deficiency in the current definition of a group and the difficulty of proving that someone misstated his investment intent in an initial Schedule 13D. We concur with the premise of this section that the courts should be given authority to find the existence of a group, even in the absence of a specific agreement, based upon evidence of "coordinated" activity and "consciously parallel" conduct. The definition of a group should be sufficiently flexible to prevent parking schemes and other coordinated activities which may evade disclosure under current law. However, we are concerned that the definition might sweep in normal arbitrage activity on the theory that arbitrageurs are generally aware of the fact that they are acting in a parallel manner. We therefore, suggest a compromise position. The section could be amended to provide that the court may consider parallel conduct as evidence of a group. This would give the courts the flexibility to deal with evasive conduct without creating a trap for the unwary.

We also agree with the section's approach in imposing a standstill after a change of investment intent. But the six-month standstill provided in this section appears to be larger than needed. Someone might honestly change his investment intent, even in the absence of a material change of circumstance. A delay of thirty days would be sufficient to deter the dishonest person from filing false statements without imposing an excessive penalty on the honest person who merely changes his mind. Moreover, it would provide the market with ample time to digest the new information.

Finally, we do not oppose prohibiting false statements in Schedule 13Ds. We question the need, however, for another provision prohibiting false statements. They are already prohibited by Rule 10b-5 and Section 32(a) of the Securities Exchange Act.

D. *Section 6. Civil Liability.* Section 6 addresses a legitimate problem -- the lack of an effective deterrent to violations of Section 13(d) and the margin regulations. Some courts have suggested that the SEC is limited to obtaining an injunction requiring corrective disclosure and preventing a repetition of the violative conduct in the future. This is obviously an insufficient deterrent to violations.

However, we do not believe that the approach taken in Section 6 is the most constructive way to solve this problem. It would authorize targets and other "aggrieved persons" to bring suits against bidders for alleged violations of Section 13(d) and the margin rules to obtain damages and injunctive relief, including orders prohibiting bidders from voting their shares, compelling divestiture of their shares, and enjoining a tender offer or other attempt to obtain control. While damages would not be available for a bona fide mistake by the bidder, the full panoply of injunctive remedies would apparently be available even for technical errors.

We oppose this approach. We believe that it could produce endless litigation in every takeover situation. The section would effectively give targets the tools to stall bids for months or even years. The courts have refused to grant targets standing to seek such remedies based upon the sound observation that they would provide them with strong incentives for filing lawsuits designed to "obstruct, delay, or exhaust" their opponents with frivolous litigation.[2] The courts have recognized that such remedies would provide powerful, new tactical weapons for incumbent managers, and tilt the balance decidedly in their favor.[3] The goal should be to eliminate abuses on both sides, not to create more.

The section compounds the problem by providing a right of action to "any person" who might somehow be "aggrieved" by a technical violation. This appears designed to subject all takeover bids to challenges by every special interest group which might be potentially affected by the potential change in control. This would cover citizens of every state in the nation in which the target does business. The potential abuses of such a broad remedy are obvious.

We believe the better approach is to provide new enforcement remedies for the SEC. The SEC should be given the power to seek the type of meaningful injunctive relief suggested by the section.

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[2] *Hubco, Inc. v. Rappaport*, 628 F. Supp. 345, 352 (D.N.J. 1985).

[3] See generally *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58-60 (1975).

This would place the necessary remedies in the hands of a neutral third party which could bring enforcement cases when appropriate without creating the very real risk of endless tactical litigation. Indeed, we would support allowing the SEC to seek monetary fines as well as injunctive relief in appropriate cases.

E. Section 7. Tender Offers. Section 7 would increase the minimum tender offer period to thirty-five business days and require that an investor make a tender offer for any shares that he intends to purchase in excess of fifteen percent of an issuer's outstanding stock. Our view is that the current twenty business day period is sufficient to give shareholders time to decide whether to tender. Indeed, while the proposed extension of the offering period is being promoted as a protection for investors, it would in fact be contrary to their interests. It would provide incumbent managers with more time to defeat the offers. Further, it would tend to reduce the premiums that could be offered since delay and uncertainty undercut the value of any financial transaction.

We would support converting the current twenty business day offering period to thirty calendar days, which is slightly longer, to avoid any confusion. This is the period which the SEC Advisory Committee on Tender Offers recommended in 1983. However, whatever the length of the tender offer period, we believe that it should be stated in calendar days for the sake of clarity.

We support limiting the percentage of stock which a person can acquire without making a formal tender offer. Such a limit is needed to prevent "creeping tender offers" and "market sweeps." These acquisition techniques undermine the tender offer process itself by allowing acquirers to make "end-runs" around the Williams Act. However, we believe that the fifteen-percent threshold suggested in the bill is somewhat low. A twenty-percent threshold would be sufficient to prevent circumvention of the Williams Act and yet high enough that it would not impair normal block transactions.

Blocks of stock in excess of the fifteen-percent threshold are common. There are thousands of such blocks. They have been formed, for the most part, for reasons having nothing to do with corporate control contests. Many are owned by individuals. Our view is that our laws should not restrict normal market activities unless absolutely necessary. The valid objectives of this section can be attained, without unnecessary restrictions, by adopting a twenty-percent cap for acquisitions made other than by means of a formal tender offer.

We believe, however, that the twenty-percent cap should apply to issuer repurchases as well. Open market sweeps by targets can be as coercive and harmful to shareholders as sweeps by bidders.

F. Section 8. Actions by Issuers. We believe that balance cannot be achieved unless target company managers are prohibited from establishing poison pills, golden parachutes, and lock-up defenses or paying greenmail, without their shareholders' approval. These practices undermine investor confidence in the integrity and fairness of contests for corporate control. They can be used by target company managers who may have only a small ownership interest in a company to prevent the true owners, the shareholders, from receiving legitimate, fair offers for their investment. Thus, when they are adopted without shareholder approval, these defense tactics raise serious questions about the motivations of the target company managers who use them.

Section 8 of the bill does not go far enough in a number of respects in prohibiting abusive defense tactics. Indeed, it is not likely to have any practical effect on several of the abusive defensive tactics that we believe should be restricted. It purports to prohibit target company managers from adopting poison pills and golden parachutes. However, it allows them to use the hundreds of pills that they have already put into place without shareholder approval. Further, it also allows corporate managers to continue to adopt such plans in the future, without bringing them before the shareholders for a vote. The only restriction is that they not do so during an actual bid. As the summary of the bill points out, the "effectiveness of any golden parachute or poison pills adopted prior to commencement of the tender offer ... would not be affected, even if the tender offer has the effect of triggering such pre-existing rights."

Section 8 also overlooks lock-up arrangements. The management of a corporation would therefore be free to defend itself against a takeover by issuing to itself or to a friendly

third party large amounts of additional common stock or securities convertible into common stock. The issuance of additional stock, as part of a stock lock-up defense, dilutes the voting rights of outstanding shares, thereby disenfranchising the holders of those shares. If sufficient stock is issued, a lock-up can effectively transfer control from the shareholders to management or the third party. Shareholders should be entitled to vote on these matters, which involve fundamental changes in the corporations in which they have invested.

Section 8 also overlooks another possible abusive target tactic, the use of dual classes of stock to disenfranchise shareholders of publicly-held companies. We urge the Committee to consider addressing the one-share, one-vote issue.

Section 8 does prohibit greenmail in an effective way, and we support this prohibition. However, the prohibition on greenmail does not improve the balance of the bill. The common complaint about greenmail is that it is an abusive bidder practice. It creates an incentive for bidders to make offers for companies that they have no real intent of acquiring and undermines investor confidence in the integrity of corporate control contests by raising questions concerning the bidder's intent in making an offer. In any event, greenmail serves no valuable economic function and therefore can be eliminated easily without impairing the markets. Thus, unless greenmail is authorized by the shareholders, it should be prohibited.

G. Section 9. Registration and Regulation or Arbitrageurs. We do not oppose registration of arbitrageurs. However, we believe that registered broker-dealers should be exempted from filing yet another registration statement. The summary suggests that the purpose of this provision is to obtain jurisdiction over previously unregulated entities. Further, the text of the bill exempts some entities that are already registered with the SEC or otherwise regulated, such as investment companies. Registered broker-dealers should obtain the same treatment.

H. Section 10. ERISA Amendment. We oppose insulating pension plan managers from liability if they fail to act prudently or in the exclusive interest of plan participants in making a decision whether to tender shares. The sole duty of the plan managers should be to act in the best interests of beneficiaries, and to provide retirement incomes for employees and former employees. We are not opposed to prohibiting acquirers from using the excess pension plan assets of targets to finance takeovers as long as the incumbent managers are also prohibited from dipping into excess plan assets to fund defenses and to finance their own takeover attempts.

I. Section 11. Increased Penalties for Insider Trading, Perjury, and Obstruction of Justice. Increased sanctions for insider trading and other illegal activity are appropriate areas for consideration. But the focus of this bill is on tender offer

reform. We therefore suggest that consideration of sanctions for insider trading and other illegal conduct be removed from this particular bill.

J. Section 12. Role of State Law. We strongly oppose this provision which we believe would not merely affirm the states' authority to enact anti-takeover statutes but, in fact, give them far more authority than they currently have. We firmly believe that balanced tender offer reform cannot be accomplished without preempting state anti-takeover legislation.

This Committee has jurisdiction over our nation's securities markets because fifty years ago Congress concluded that control over those markets was too important to be left to the states. Congress concluded that "transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for [federal] regulation and control of such transactions... ."[4] Congress has never returned power to the states to decide the type of fundamental national interests that are at stake here. The bill nevertheless proposes to cede power to the states and permit them to fragmentize our capital markets with an array of anti-takeover statutes adopted under the guise of regulating the internal affairs of corporations. To argue that the states are only regulating the "internal corporate affairs" of their companies elevates form over substance.

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[4] Section 2 of the Securities Exchange Act of 1934 (emphasis supplied).

The states were no threat, until recently, to upset the national policies and objectives set by Congress in the area of tender offer regulation. For many years following the adoption of the Williams Act, the federal courts held that the states were not free to protect local interests at the expense of the Act's level playing field and the national policies that the Act was intended to further. However, as you are well aware, the Supreme Court recently upheld Indiana's Control Share Acquisition Act in *CTS v. Dynamics Corp. of America*, and shortly thereafter it reversed and remanded for further consideration a lower court decision in *Ohio v. Fleet Aerospace*, which had struck down Ohio's anti-takeover statute. The Court's decisions suggest that the states have broad authority to reattion takeover attempts for our nation's largest publicly-held corporations, in order to protect their local interests, as long as they do so by regulating the "internal corporate affairs" of companies incorporated within their jurisdictions.

It is unclear precisely how far the states will be able to go in tilting the balance in favor of the incumbent management of these corporations. The *CTS* decision could be interpreted broadly as a blank check, or narrowly as merely authorizing the states to extend the minimum tender offer period to fifty days to enable the target company shareholders to vote on the offer. A broad reading could lead to fifty different state statutes which are highly restrictive. A narrow interpretation would increase the costs of

bids, and lower the premiums offered to shareholders, but would not prevent legitimate offers from reaching the shareholders. Only time will tell how the courts will interpret it.

Further, the impact of the decision is closely tied to the one-share, one-vote issue which both the Congress and the SEC are studying. The adoption of a one-share, one-vote requirement for publicly-traded companies would reduce the significance of the *CTS* decision since the Indiana law rests upon the notion that the states have the authority to strip the voting rights from shares of nationally-owned companies.

What is clear, however, is that unless Congress preempts state anti-takeover legislation any attempt to enact a carefully balanced reform bill will be futile. The states will use the Indiana statute as a starting point for the development of a broad range of new anti-takeover statutes. Nearly forty states have anti-takeover legislation on their books. Many are currently in the process of reviewing their statutes in light of *CTS* to determine how they might better protect their local interests.[5] Some, such as Delaware, are waiting for Congress to act before deciding what type of state legislation is needed.[6] If they are dissatisfied with the balance struck by Congress, they will adopt more one-sided laws to give local managers a "home court advantage."

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[5] Review & Outlook, "Life Tenure for Managers?," *The Wall Street Journal*, Apr. 23, 1987; Labaton, "For the States, a Starring Role in the Takeover Game," *The New York Times*, May 1, 1987; Cowan, "Ebb in Takeovers Foreseen," *The New York Times*, April 23, 1987.

[6] Schwadel, "Delaware Fails to Adopt Law on Takeovers," *The Wall Street Journal*, June 16, 1987; "Delaware Rejects Anti-Takeover Law," *The Washington Post*, June 17, 1987.

If these statutes were ultimately upheld, it would render irrelevant Congress' efforts to establish national policy. Thus, unless Congress acts to preempt state law in this area it will be unable to enact meaningful legislation. Any effort to create a balanced playing field will be overrun by state legislators pursuing narrow parochial interests with little or no regard for the harm that will be inflicted on shareholders or the national interest. At a minimum, these new statutes would spawn years of costly, wasteful litigation to determine their validity under CTS. In our opinion, the time has come for a uniform, national set of standards for corporate control contests.

III. CONCLUSION

Our securities markets have worked very well for over fifty years based upon a free market philosophy. The markets could easily be harmed by unnecessary and unwise regulation. Congress has a special obligation to act carefully and not to adopt regulation that might do serious damage to the competitiveness of our markets and our economy in general. Congress should therefore be careful to eliminate the abuses in the tender offer area without imposing unnecessary regulation on the free market system that has served us so well.

Recommendations of the Capital Markets Group

Any changes in the laws which govern this country's securities markets should be premised on the principle that efficiency and viability require a marketplace in which productive change in ownership of corporations and other entities can occur in a responsible fashion.

To assure that this marketplace will not be adversely affected there must be a balance between the needs and interests of shareholders, buyers and sellers.

It is the belief of the Capital Markets Group (First Boston Corp., Goldman Sachs & Co., and Morgan Stanley) that any apparent problems in the marketplace can be cured by increased disclosure, certain modifications of the law, and vigorous enforcement.

Table of Contents

I. Increased Disclosure
  - A. Sanctions For Failing to File Properly Under Section 13(d)
  - B. Extend and Clarify the Definitions of a "Group" and an "Acquisition" Under Section 13(d)
  - C. Simplify Tender Offer Disclosure Statements
  - D. Close the Section 13(d) Window

II. Insider Trading
  - A. Clarify the Definition of Insider Trading
  - B. Impose Sentencing Guidelines That Will Ensure That Insider Traders Get Tough Jail Sentences

III. Regulation of Tender Offers
  - A. Close the Hart-Scott-Rodino Partnership Loophole
  - B. Narrow the Hart-Scott-Rodino Passive Investment Exemption
  - C. Require That Acquisitions of More Than 20% of a Company's Stock Be Made by Tender Offer
  - D. Establish a 30-Calendar-Day Minimum Tender Offer Period

IV. Balanced Playing Field
  - A. Prohibit Poison Pills Without Prior Shareholder Approval
  - B. Prohibit Greenmail Without Prior Shareholder Approval
  - C. Limits on Lock-ups

V. Financing Takeovers
  - A. Limit Investment Discretion of Federally-Insured Institutions to Purchase Non-Investment Grade Debt

I. INCREASED DISCLOSURE

A. Sanctions for Failing to File Properly Under Section 13(d)

Current law. There is currently no effective sanction for failing to file a Section 13(d) statement, filing a statement which is inaccurate as to the acquiror's intentions, or failing promptly to disclose changes in the stated purpose for acquiring the securities after filing the statement. The SEC and private investors can seek injunctive relief to redress violations of Section 13(d), but it is not clear that anything other than the filing of a corrective 13(d) statement can be compelled.

Recommendation. Section 13(d) should be amended to prohibit any person who has violated the timely filing requirement from (1) voting, (2) disposing of, or (3) increasing his or her holdings of the securities to which the filing relates for a period of 30 days after corrective disclosure is made. A person should also be prohibited from acquiring additional securities for 30 days after changing the disclosure in a 13(d) statement concerning his investment intent.

Comments. The lack of an effective sanction for violating Section 13(d) may encourage violations of the prompt disclosure requirements of the section. Investors may be tempted to acquire securities under the cover of a false 13(d) statement or without even filing a statement because they cannot be required to sell the securities that they have obtained by violating the section.

The recommended changes would correct the deficiency in law. The requirement that an investor wait for 30 days after changing the statement concerning his or her investment intention is recommended because of the difficulty in proving that the investor misrepresented his intention in the first instance. This will ensure that investors speak candidly when stating their investment purpose in Section 13(d) statements.

B. Extend and Clarify the Definitions of a "Group" and an "Acquisition" under Section 13(d)

Current Law. Section 13(d) requires any person, partnership, syndicate, or "group" of investors "acquiring" beneficial ownership of more than 5 percent of the voting stock of a publicly-held corporation to disclose information about the acquisition. The purpose of this disclosure is to alert the marketplace, at an early stage, to large accumulations of securities which might lead to a change in control of publicly-held corporations.

Under the current statute and SEC rules thereunder, the disclosure obligation does not apply to acquisitions of securities by investors who act in concert unless they have in fact entered into a written or oral "agreement" that they will act in concert. Further, the definition of an "acquisition" does not include an option or other contract to acquire securities unless it is exercisable within 60 days.

Recommendation. Section 13(d) should be amended to make clear that a group includes all beneficial owners who act in concert pursuant to any understanding whatsoever, whether or not it rises to the level of an "agreement" under contract law, and to eliminate the 60-day loophole on options and other contracts to acquire securities. The job of improving the definitions of a "group" and an "acquisition" should be assigned to industry professionals who understand the workings of the market and will be able to craft definitions which will not interfere with desirable market activities.

Comments. There is concern that the present definitions of a "group" and an "acquisition" have loopholes which are permitting concerted activities to go unreported. This is especially so because there are presently no effective civil penalties for the failure to file a timely Section 13(d).

Disclosure should be required of all concerted activities among investors regarding the acquisition of stock and the use of voting or investment control over stock to effect a change in control. The definition should be flexible enough to cover conscious parallel conduct even if the parties have not expressly "agreed" to act in concert.

The 60-day loophole for options and other contracts to acquire securities should also be eliminated. This loophole could be used by an investor or group of investors to obtain the right to acquire a controlling interest in a corporation before there is any obligation to report this fact. The Section 13(d) filing would merely announce to the world that a change of control had, in effect, already taken place.

C. Simplify Tender Offer Disclosure Statements

Current Law. The SEC's disclosure rules result in unnecessarily lengthy and complex disclosure statements.

Recommendation. Congress should direct the SEC to report to the Congress the steps it has taken in response to the recommendation of the SEC Advisory Committee on Tender Offers that tender offer disclosure should be simplified.

Comments. Tender offer disclosure documents are needlessly complex and contain lengthy boilerplate language which obscures material information and may confuse shareholders. The SEC Advisory Committee on Tender Offers recommended eliminating unnecessary or duplicative information, and requiring a concise statement in plain English of the price, terms, and key conditions of the offer. In addition, the Advisory Committee recommended that the SEC revise its rules to permit inclusion of the key conditions in a summary advertisement used to commence a tender offer. Thus far, the SEC has not acted on these recommendations.

D. *Close the Section 13(d) Window*

Current Law. Section 13(d) of the Williams Act requires that a person file a disclosure statement with the SEC within 10 days after he acquires more than 5 percent of a company's voting stock. There is no requirement that the person stop purchasing securities during the 10-day window period. Thereafter, the person must amend the disclosure statement each time he acquires an additional 1 percent of the outstanding shares. There is no requirement that a person stop purchasing if he does not file promptly.

Recommendation. Require SEC filing and public announcement *prior* to crossing the 5 percent threshold.

Comments. The 10-day window presents acquirors with the opportunity to make purchases substantially in excess of 5 percent before the Section 13(d) disclosure statement is filed, thereby allowing for circumvention of the purpose of the Williams Act -- adequate notice of potential changes of control. In 1968, when the Williams Act was enacted, a 10-day window was not unreasonable. But under today's high volume market conditions vastly greater quantities of stock can be purchased in a matter of days.

Proposals have been made to close the 10-day window to two days or one day. It is recommended that Congress go one step farther -- require filing and announcement *before* crossing the 5 percent threshold, thereby closing the 10-day window *completely*. This will not only prevent creeping tender offers -- rapid open market and privately negotiated transactions prior to the announcement of a takeover attempt -- but also market sweeps during and immediately following the withdrawal of formal tender offers by persons who have not previously disclosed their intentions.

It is not advisable to reduce the 5 percent threshold. Reduction of the threshold would increase dramatically the number of filings made each day. The vast majority of those filings would not be related in any way to a possible change of control of a company. Congress determined, correctly, when the Williams Act was enacted, that a 5 percent threshold would provide adequate notice of potential changes in control, while avoiding the flood of filings that would result if a lower threshold were used.

II. INSIDER TRADING

A. *Clarify the Definition of Insider Trading*

Current Law. The current law of "insider trading" is at best confusing and at worst ineffective in prohibiting the misuse of confidential information in trading in our national securities markets. The "insider trading" law has been developed by the courts under general antifraud provisions. There is currently no statute which deals specifically with the subject of misuse of information in trading.

The current law is set forth in two recent Supreme Court decisions, *Chiarella* and *Dirks*. These decisions hold that a person trading on nonpublic information is not engaging in securities fraud unless he is under a fiduciary duty not to trade on the information or disclose the information. The decisions prohibit trading by corporate insiders, but tippee trading is illegal only if it benefits an insider.

Chiarella and *Dirks* have created substantial doubt whether it is illegal for "outsiders" who have no fiduciary relationship with a corporation and its shareholders to trade on information that is stolen, misappropriated, or obtained by other illegal or unethical means. The SEC and the Justice Department have attempted to plug the loopholes left by *Chiarella* and *Dirks* by creating a special rule, Rule 14e-3, to deal with trading on information relating to tender offers, and by relying on a "misappropriation" theory of fraud which focuses on whether the owner of information has been defrauded. Many people question whether these stopgap measures are valid and whether they are appropriate vehicles for prohibiting misuse of confidential information in our national securities markets.

Recommendation. A special statute should be enacted separate and apart from the general antifraud provisions of the federal securities laws, to deal with the subject of trading on the basis of nonpublic information. The details of the statute should be worked out by securities professionals, who are familiar with the workings of the securities industry and who understand how to craft a statute which will not interfere with healthy and desirable market activity.

Comments. Enacting a special statute separate from the "fraud" statutes will permit the law to focus on the proper issue: whether a trading advantage has been obtained by lawful means, such as through legitimate research and analysis, or whether it has been obtained by illegal means, such as by bribing an insider. Trading on the basis of knowledge acquired lawfully should be encouraged since it promotes market efficiency. Trading on the basis of information which has been obtained by illegal means should be prohibited whether or not it would constitute "fraud" under the existing statutes.

B. Impose Sentencing Guidelines that Will Ensure that Insider Traders Get Tough Jail Sentences

Current Law. Section 32 of the Securities Exchange Act currently permits federal judges to impose prison sentences of not more than 5 years for insider trading. However, there are currently no sentencing guidelines imposing any obligation on a federal court to give a defendant any prison time for insider trading. Prison sentences have been rare; many convictions result in probation or suspended sentences. Federal prosecutors have expressed the view that the courts have been lenient in their treatment of insider traders because people who engage in this crime are frequently well-educated, wealthy, first-time offenders and there is difficulty in identifying real "victims" of insider trading schemes.

The U.S. Sentencing Commission has prepared sentencing guidelines which cover insider trading as well as other types of crimes. The guidelines will be submitted to Congress by April 13. However, the guidelines appear to be relatively lenient to insider traders. The guidelines would require a court, absent special circumstances, to impose a prison sentence of 0 to 6 months on a person who makes up to $500,000 in an insider trading scheme. Such an extraordinarily light sentence will hardly serve as a deterrent to a crime with such enormous profit potential.

Recommendation. Congress should impose sentencing guidelines that are tough enough to overcome the natural reluctance of judges to impose heavier sentences on insider traders. It should toughen the sentencing guidelines that are being suggested by the U.S. Sentencing Commission.

Comments. The amount of insider trading taking place in our securities markets will not be reduced substantially unless insider trading results in the actual imposition of substantial jail sentences for insider trading convictions. Such sentences will demonstrate that our society views the crime of insider trading as a serious offense.

III. REGULATION OF TENDER OFFERS

A. Close The Hart-Scott-Rodino Partnership Loophole

Current Law. Whether a proposed merger is subject to the Hart-Scott-Rodino Antitrust Improvements Act depends in part on the size of the companies involved. An acquisition is not subject to these requirements unless one of the parties has assets or annual sales of $100 million or more, and the other party has assets or annual sales of $10 million or more. When an acquiror is a partnership, only the assets of the partnership, not those of the partners, are considered in determining whether the thresholds for antitrust review are met.

Recommendation. Close the Hart-Scott-Rodino partnership loophole. When a partnership is used as an acquisition vehicle, the assets of the partners should be counted in determining whether the size-of-the-parties test for filing has been met.

Comments. The Hart-Scott-Rodino notification and waiting period requirements are intended to afford the Federal Trade Commission ("FTC") and the Antitrust Division of the Department of Justice an opportunity to review the antitrust implications of certain large acquisitions before they are consummated. However, antitrust review currently may be avoided by using a partnership as the acquisition vehicle in a takeover. The Hart-Scott-Rodino act should be amended to require that the assets of each partner be counted in determining the size of a party making an acquisition.

The FTC is presently working on amending its regulations to eliminate the partnership loophole. If adequate regulations are promulgated, legislation should be unnecessary. The FTC's rules are applicable whether antitrust review is conducted by the FTC or the Antitrust Division of the Department of Justice.

B. Narrow the Hart-Scott-Rodino Passive Investment Exemption

Current Law. Acquisitions of securities are subject to the prior notification and waiting period requirements of the Hart-Scott-Rodino Act if the parties involved are sufficiently large and if, after the acquisition, the acquiror will hold at least 15 percent or $15 million of the other company's securities. The notification and waiting period requirements afford the FTC and the Antitrust Division the opportunity to review such acquisitions for possible antitrust problems before they are consummated.

Under the FTC's rules, however, an acquisition is not subject to the notice and waiting period requirements, even though it exceeds the $15 million trigger, if the acquisition is for no more than 10% of the company's securities and it is made "solely for the purpose of investment." The FTC rule applies, of course, whether review would be conducted by the FTC or the Antitrust Division. The FTC's regulations and interpretations of the "investment exception" include a confusing variety of tests for determining whether an investment is "solely for the purpose of investment."

Recommendation. The "investment exception" to the Hart-Scott-Rodino requirements should be simplified and clarified so that there will be certainty and predictability in determining whether an acquisition is "solely for the purpose of investment."

Comments. The scope of the investment exception is not clear. The FTC's rules provide that voting securities are held or acquired "solely for the purpose of investment" if the acquiror "has no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer." The FTC has listed a variety of types of conduct that "could" be viewed as inconsistent with passive investment intent, including soliciting proxies and being a competitor of the issuer. The FTC has also interpreted the investment exception as applying only to "passive investors" who do not attempt or intend to influence management.

Although the FTC has in some cases closely scrutinized claimed "investment" purchases made shortly before unsolicited takeover attempts, it is unclear whether the FTC is required to do so, and what specific guidelines it will apply.

C. Require That Acquisitions of More Than 20% of a Company's Stock Be Made By Tender Offer

Current Law. Under current law investors may acquire a controlling block of stock by means of purchases of stock in the open market; there is no requirement that they do so by tender offer.

Recommendation. Require that any purchases that would result in the ownership of more than 20% of a company's stock be made pursuant to a tender offer, subject to exceptions designed to avoid conflicts with normal operations of the marketplace.

Comments. Currently, it is possible to acquire a controlling amount of stock rapidly in open market transactions without complying with the equal treatment provisions of the Williams Act which are applicable to tender offers. In one case, a bidder purchased 25 percent of a target's stock on the open market in a two-hour period after withdrawing its tender offer. In another, the target repurchased over 50 percent of its stock in the open market in less than 5 days in a successful defense against a tender offer.

These open market purchase programs deny shareholders the premium price that usually is required to purchase a controlling block of shares, and exclude most shareholders, usually the less sophisticated ones, from the opportunity to sell their shares to the control-seeking purchaser. To assure that all shareholders have such an opportunity, acquisitions over 20% should trigger the protections of the tender offer process, including the right of all shareholders to tender their shares for an equal price.

The threshold should not be set lower than 20 percent. An acquisition of less than 20% is seldom sufficient for control. Moreover, a threshold of lower than 20% could have harmful effects. It could limit the ability of dissident shareholders to acquire sufficient stock to engage in a proxy fight with incumbent management.

The CHAIRMAN. Thank you, Mr. Bachmann.

Mr. Bachmann, reading your testimony and comparing it with that of Mr. Greenhill today who's representing Morgan Stanley, First Boston, and Goldman Sachs, I'm hard-pressed to find any real differences. In fact, the two statements could easily have been written by the same person. Were they, incidentally?

Mr. BACHMANN. No.

Mr. GREENHILL. No.

The CHAIRMAN. And yet you're not only chairman of the Securities Industry Association but also the extraordinarily capable managing director of Edward Jones. Edward Jones is an organization for which I have the greatest respect. You have a number of offices in our State and you have them in small towns. You reach probably more people than any other securities firm. Is that correct? How many branches do you have?

Mr. BACHMANN. 1,250.

The CHAIRMAN. Well, I think that's marvelous. You are distributed throughout the country very widely.

Do the regional firms such as yours really share the exact same views as the Wall Street firms on this issue? If not, what are the differences?

Mr. BACHMANN. Well, the way we approached it, if I could go back, we became involved in the tender offer legislation as a part of looking at the entire insider trading problem which we believe has a profound effect on the confidence in the markets and the confidence in our industry. So as a part of that process, we examined all these issues and the tender offer part of the examination was extracted and that's what I'm presenting to you today.

It was brought to the entire board and it was discussed by the board which is made up of firms of every size and type in the securities industry.

The CHAIRMAN. To what extent is the Securities Industry Association controlled by or influenced by leading Wall Street investment banking firms?

Mr. BACHMANN. Well, probably not as much as they would like, I think.

The CHAIRMAN. That's hard to believe, reading your testimony.

Mr. BACHMANN. Well, I can't explain that because Mr. Greenhill and I had not met until 10 minutes ago. And other than that, his firm is the exact antithesis of ours. I do think this. I think that our concerns focus in two areas. One is on what we call investor protection, which in truth is fairness. I view it as a fairness issue. And the other is trying to keep things evenhanded.

Now the difficulty we have—and I don't know that I'm supposed to go into antedotes, but I guess I almost have to. One of the fierce battles going on today involves the leading department store chain in Minneapolis and yet that company is really the accumulation of companies through a series of acquisitions they made. Which are the good ones and which are not the good ones is difficult to distinguish. But we do think that there have to be some clear rules and that a bright spotlight has to be placed upon what is taking place so that the public has immediate access to the information.

I think that we're going through a difficult transition from basically an industrial society to a society that's quite different that's really driven by technology.

The CHAIRMAN. Mr. Greenhill, you say that lengthening the minimum tender offer period to 35 working days or 7 weeks would be unfair to shareholders because it would give management more time to defeat the offer and you say it would be costly.

Is it wrong to give management time to fight a tender offer, to make their case to the shareholders? Why isn't that in the interest of an informed decision by the shareholders so they know what's going on? Why does this give management any more advantage than it gives the raider?

Mr. GREENHILL. Mr. Chairman, let me first say that in working on matters of this sort we represent targets as well as the acquiring side. So we have some view of the process.

MORE TIME MEANS HIGHER COSTS

And the issue is how much time is enough time? One thing we do know is that time is costly because you pay for the financing arrangements every day that passes.

I think there are two concerns I would have if I were——

The CHAIRMAN. Let me just interrupt at that point. You've had a great deal of experience here. It would be helpful if you could document that. You've gone through a number of these takeovers. In other words, tell us how much it would cost? When you're dealing with the kind of money that you folks make, it seems to me you have to show it would cost a great deal more to discourage any kind of takeovers that you're involved in.

Mr. GREENHILL. Mr. Chairman, I've had the privilege of being in this business I guess 25 years. I formed the merger and acquisition group at Morgan Stanley in the early 1970's and now I run all the investment banking and I'm still involved in deals, and I guess I have had a fair amount of experience.

But one thing that's always been the same. The more amount of time you have, the more you've got to pay. The question really is twofold. From the point of view of the investor, how much time is enough to make a considered decision? And I think Mr. Bachmann has already spoken on that. The SEC has spoken on that.

The second issue is from the point of view of the target company managers, how much time is enough to prepare defenses if that's what is necessary? And in my experience and my experience goes on for a number of years, the present system, we would make it 30 calendar days instead of 20 business days, is perfectly adequate. If you go beyond that time period, there must be some other reason why you're stretching the time period and I don't see in the record—I've had the privilege of reading some of the hearing testimony—any empirical evidence that indicates that the present time standard isn't adequate.

The CHAIRMAN. My time is up. Before I call on Senator Bond, let me say that you go back 25 years with Morgan Stanley. I go back 47 years. I went up to Morgan Stanley hat in hand and asked for a job in 1940. They say, "No way." They sent me over to J.P. Morgan

& Co., where I got a job for $25 a week. So you can see that there are reasons for our disagreement. [Laughter.]

Mr. Greenhill. I think you chose the right course.

The Chairman. Well, I didn't end up in either place. I ended up here with a lot less money, I'll tell you that.

Senator Bond.

Senator Bond. Thank you, Mr. Chairman.

Perhaps with respect to the question of the relative compensation between executives in the securities industry and the salaries of U.S. Senators, the capital markets may place a higher value on the services you provide than on the services we provide, but I won't pursue that any further and I don't ask you to comment on that. [Laughter.]

I would like to address a question which has been discussed frequently before this committee.

There are critics of corporate takeovers who claim that these corporate takeovers are merely paper transactions that create no wealth. They claim that shareholders in corporations realize no net economic gains from corporate takeovers. They are concerned about the effects of the corporate takeovers on the employees of the corporations and on the communities. We have heard reference to a study conducted by Professor Lowenstein at Columbia University to suggest that there is little real wealth created by corporate takeover activity and I would ask both of you gentlemen whether you have any studies or whether you have any information which would take issue with the views expressed by the critics, whether you have any studies or other information that might contradict the findings of the Lowenstein study?

Mr. Bachmann. I can't point to specific studies. I have seen studies on both sides. I think much, perhaps too much, is in the eyes of the beholder.

Senator Bond. Well, what's your view of it? Since we have a long—I might add, Mr. Chairman, that when Mr. Bachmann and I first met, he was campaigning for a State senate seat and he chose to go a different route, which brings him to the table at this time.

The Chairman. Does that mean he's a Democrat?

Senator Bond. No, sir.

The Chairman. Nobody's perfect.

Mr. Bachmann. I would pause at this moment and say the voters chose that I would take a different course. [Laughter.]

Senator Bond. I've had a similar mandate, but I didn't give up. What's your view? You've had experience in the securities industry.

Mr. Bachmann. My view is that the role of the capital markets is the movement of capital from less efficient to more efficient places, that we have all kinds of new impacts which are speeding up the process. I think the principal ones, as I see them, are technology and the encroachment of the rest of the world, which we simply are part of whether we want to be or not. With our small firm, we have people coming to see us from Australia and places like that to talk about relationships and we have no idea how they even found out about us.

I think we've got to keep the capital markets flowing so that people can make these judgments. It's been pointed out that there have been some real errors made in many of the transactions, but there are also errors made in start-up companies. The nature of our system. People are going to see opportunities and they're going to try them and at times they will succeed and at times they won't. I think the key is to keep the capital markets as evenhanded as we can so that neither entrenched management nor a raider has the upper hand.

Senator **Bond**. Mr. Greenhill?

Mr. **Greenhill**. Yes. Our economist, John Paulus, has done a study on the effect of restructuring in a number of economic sectors. That study has been available since last November and it deals with the increased productivity industry by industry in which massive restructuring has taken place. We would be happy to make that available to you and to the rest of the committee, Senator.

I think what it shows is that in a certain number of industries where important restructuring has taken place that productivity has in fact increased. I think we've seen industries and you've seen industries in which a lot of overhead has been put in place and as economic conditions change the overhead has to be reduced and shifted. The oil industry is one of those. There are a lot of painful cases in this country, in which, if we're going to be competitive in the world, we're going to have to have a very cost-effective system, and this process helps to improve the cost effectiveness.

There are plenty of mistakes made here. There are plenty of mistakes in the capital expenditure process. I think one of the comments that I would like to make, because it comes up in this restructuring or in the merger and acquisition business or indeed in corporate life, is that there are a number of cases where plants close, workers are put out of work. These are very difficult situations. Our point of view, the Capital Markets Group is, is that it's important to evaluate carefully the interests of the workers as well as the interests of the shareholders. While I think we haven't yet formulated a specific position, I wanted this committee to know that we think that new owners should sit down with existing collective bargaining units and negotiate a relationship which is in the common interest of the company and its employees. I think perhaps this is one way in which some of these issues can be addressed, and I think you will be hearing more from us later about that concern.

Senator **Bond**. We would welcome the study.

Thank you, Mr. Chairman.

The **Chairman**. Thank you.

Senator Wirth.

Senator **Wirth**. Thank you very much, Mr. Chairman.

Gentlemen, thank you very much for being here and for your very good testimony, especially, Mr. Greenhill, I read with interest all of your specific comments and greatly appreciate it.

Let me, if I might in the short time available, ask you to comment on two areas. One relating to pension funds and the other to State jurisdiction.

On the first, we have seen situations in which there have been takeovers of companies that had overfunded pension funds and in a situation like that, the new management has used the overfunded pension funds situations either to help them restructure the company or to pay down some of the debt.

The question that arises in my mind is, if that occurs and if then down the line the company ends up not having appropriate amounts of money in the pension fund, the Federal Government ends up picking up that liability.

That raises the question, doesn't it, should we be taking on the issue of pension funds and, if so, should that be done in this legislation. If so, how ought we to go about doing it?

Mr. BACHMANN. Well, first of all, I think that the question once again should be evenhandedness. I think neither side should have access to those.

Senator WIRTH. So we should fence off the pension funds?

Mr. BACHMANN. It should not be used by either side.

Senator WIRTH. Does that mean that we ought to in legislation fence off those pension funds so they can't be used in any way, that they should be inviolate for the employees?

Mr. BACHMANN. I don't think that this forum is the forum for that. I think that that should be looked at as a part of the entire pension fund analysis. It should be done in that setting because there are all kinds of relationships and it would have to be done in the context of those.

Senator WIRTH. But we are seeing various takeovers and the use of pension funds and it would seem to me that pension funds are often looked at by the potential raider or by management as a tool that they can use as a defense or as a way of paying down their debt or whatever. Therefore, pension funds become involved in the whole process of takeovers. Therefore, one could argue that certainly this is a vehicle that ought to be taken on.

Mr. GREENHILL. I think the integrity of pension funds is a very important issue. I think the issue, however, goes beyond the tender offer process because there are many corporate transactions in which the pension surplus, or so-called surplus, is dealt with. I think the other matter relating to pension funds is that in our opinion pension fund managers should be subject to the same standard of prudent judgment when they invest in a stock that's a subject of a takeover offer as when they invest in any other stock.

Senator WIRTH. That's not the thrust of my question. I understand what you're saying but that's not the thrust of my question. My question is, what happens to the pension fund that is owned by a company or the employees of that company when that company is taken over?

Mr. GREENHILL. We would have no problem—the Capital Markets Group—in measures designed to strengthen the integrity of the pension fund. We think that if that is addressed it should be addressed in a forum that goes beyond the acquisition process because indeed matters can be taken into account that are far beyond the acquisition process.

Senator WIRTH. Well, couldn't we very simply in this legislation, following I guess Mr. Bachmann's suggestion, fence off the pension funds in some fashion?

Mr. GREENHILL. I don't think it's as simple to do that because the issue, as you know, Senator Wirth—and you've had many discussions on this before—is when is a pension fund adequately funded? It's a technical issue, and the Government ends up paying the deficit if somebody finds out that in fact it wasn't adequately funded.

But we would have no problem—I wouldn't fence it off because you first have got to decide whether it is or is not adequately funded.

Senator WIRTH. But even not addressing that, whether it is or is not adequately funded, why can't you just say that that's off limits in terms of any kind of takeover transactions?

Mr. GREENHILL. We would have no problem with that if it went beyond that and said it's off limits in all respects to normal corporate management.

Senator WIRTH. That management couldn't use it to defend themselves and that raiders couldn't use it to pay down the debt or whatever it may be. It's just off limits.

Mr. GREENHILL. And in the ordinary course of its business, whether a tender offer was in process or not, management couldn't access the pension fund. In other words, there's a third area that this doesn't deal with that is just as important. The so-called pension fund reversions in the ordinary course of business operate in that area.

Senator WIRTH. Maybe, Mr. Bachmann, we might, with the help of Mr. Greenhill and others, we might get your suggestions as to—beyond saying don't deal with it here, I think maybe we're saying that this is a vehicle that we ought to deal with here and just put it off limits. And if that is the case, you might be able to suggest to us the kind of language or approach that would make this possible. Might we do that?

Mr. BACHMANN. Yes.

Mr. GREENHILL. I think we would be supportive.

Senator WIRTH. My time has expired, Mr. Chairman. I hope we can come around again and I can come back and talk a little bit to Mr. Greenhill in particular about his suggestions related to States. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Let me ask you gentlemen a question on the period of time for tender offers. I think both of you suggested 30 days. Would it make a difference if the tender offer were a straight cash offer, no complexities about preferred stock or debentures or something or other coming along later? It's just $27 a share, period, for every shareholder. Let's take the easiest case, offering it to everyone.

Now in that case, maybe the time could be shorter. Do you think so or what do you say?

Mr. GREENHILL. I think the issue—and the SEC commented on this in earlier testimony—is what is the adequate amount of time for which investors should understand the offer and be protected? If the transaction was only for cash, one element of the transaction is fairly simple—that is what they are getting. The other issue is, what is the value of the corporation? And I think 30 calendar days represents, in our view, a fair balance.

You know, it's funny. I find that the small investors exercise great common sense when it comes to money. The only people I've found in my experience in the business that really end up in the wrong box on one of these tender offers are the so-called sophisticated institutions that think they are going to act as arbitrageurs and try to play for every penny at the end of the game. Most of the small shareholders in fact act very prudently, and we haven't found that to be a problem.

As you know, Senator, if the offer consisted of debentures, preferred stock, and so forth, with the registration requirements of the SEC, by necessity, a significant time delay is involved.

Senator CHAFEE. Well, what you're saying is that you wouldn't draw a difference in time?

Mr. GREENHILL. No. The present system seems to protect investors and gives the companies adequate time to mount defenses, and we work on a lot of those.

Senator CHAFEE. What do you say to that, Mr. Bachmann?

Mr. BACHMANN. Well, I have to view it from the standpoint of the investor and the question is, how much time does it take for an investor to examine and evaluate and come to a conclusion? I think that 30 days is an adequate period, regardless.

Senator CHAFEE. When you say investor, you mean the investor in the targeted company?

Mr. BACHMANN. I'm talking about the shareholders. My world is primarily one of individual investors.

GOLDEN PARACHUTES AND POISON PILLS

Senator CHAFEE. Mr. Greenhill, you didn't mention barring golden parachutes, poison pills, except with the shareholders' approval under all conditions. Mr. Bachmann indicated why make it any different in connection with takeovers, that there ought to be a law that you can't have golden parachutes or poison pills or any of those defenses or delightful retirement benefits for management without a shareholders' vote. That's what Mr. Bachmann said. They are not different. You ought not permit it under any way, period, without shareholder approval. What's your view?

Mr. GREENHILL. Our point of view is that the shareholder vote is the basic smell test by which you ought to test each of these devices.

If the management or the company hasn't gone to the shareholders to authorize golden parachutes, to authorize poison pills or any other defensive device, our view is they should be prohibited.

Senator CHAFEE. Now, Mr. Bachmann, in your verbal presentation you didn't spend as much time on the problem of States as Mr. Greenhill did, although I note in your printed submission you are concerned about the role of State law.

Do you echo what Mr. Greenhill said on that point?

Mr. BACHMANN. As I understand it, the way the bill is proposed, anybody could file a suit and basically this becomes a delaying tactic and we think that there should be a Federal preemption.

D. Establish a 30-Calendar-Day Minimum Tender Offer Period

Current Law. Under existing SEC regulations a tender offer must remain open for 20 business days.

Recommendation. Substitute a 30-calendar-day minimum tender offer period for the current 20-business-day period.

Comments. The minimum offering period should be measured by calendar days rather than business days to reduce the potential for confusion and mistakes. The recommended 30-calendar-day period is slightly longer than the 20-business-day period.

The 30-day period provides ample time for investment decisions. The purpose of a minimum offering period is to give all shareholders of the target company an equal opportunity to participate in the tender offer, and to give those shareholders sufficient time to make informed investment decisions. The SEC Advisory Committee on Tender Offers concluded in 1983 that 30 days is sufficient.

Proposals have been made to extend the tender offer period beyond 30 days. It would not be advisable to do so. Additional lengthening of the period would provide no benefit to shareholders, who have adequate time to evaluate a tender offer under a 30-day provision. It would mainly provide an opportunity for gamesmanship and would make the tender offer process so expensive that it would violate the principle of neutrality between bidders and targets that was established by the Williams Act.

IV. BALANCED PLAYING FIELD

A. Prohibit Poison Pills Without Prior Shareholder Approval.

Current Law. Poison pills are warrants or other securities which give shareholders the right to acquire additional shares at bargain prices in the event of an unfriendly takeover attempt. Poison pills make it difficult if not impossible for a bidder to acquire control of a company without the incumbent management's approval. If the bidder acquires sufficient stock to trigger the pill, the voting rights and market value of his stock become diluted by the issuance of additional "cheap" stock. The use of poison pills without shareholder approval was upheld by the Delaware Supreme Court in 1985.

Recommendation. Prohibit poison pills, unless there is prior shareholder approval.

Comments. Poison pills represent the most abusive entrenchment device which has been permitted by state law. Poison pills give incumbent managers almost complete control over whether an offer will be presented to shareholders. Poison pills therefore prevent bidders from making legitimate attempts to replace inept corporate management, and deprive shareholders of the opportunity to consider fair tender offers.

B. Prohibit Greenmail Without Prior Shareholder Approval

Current Law. The term "greenmail" refers to the purchase by a corporation of its own stock at premium prices from a person who holds sufficient stock to threaten a takeover. Greenmail is not prohibited under current law.

Recommendation. Prohibit greenmail unless approved by a majority of the target's disinterested shareholders.

Comments. Greenmail should be prohibited, first, because greenmail payments are made selectively and discriminate against disinterested shareholders (i.e., shareholders other than directors, officers and potential greenmail recipients), and second, because it casts doubt on the integrity of the takeover process.

Although the problem of greenmail can be solved on a company-by-company basis by the adoption of charter amendments proscribing greenmail payments, it would be advisable to enact legislation that would proscribe greenmail across-the-board.

A reasonable prohibition against greenmail would prohibit corporations from repurchasing their stock at premium prices from investors who have held large blocks of stock (e.g., more than 5 percent) for relatively short periods of time (e.g., less than 2 years). Since the primary purpose of proscribing greenmail is to protect disinterested shareholders, there should be an exception for greenmail payments that are approved by the disinterested shareholders.

C. Limits on Lock-ups

Current Law. There is currently no federal statute prohibiting lock-up defenses to hostile takeover bids. The rules of the New York Stock Exchange ("NYSE") prohibit a company from issuing common stock or securities convertible into common stock, without shareholder approval, if (1) the issuance of such securities would result in an increase of 18 1/2 percent or more of the company's outstanding shares or (2) the value of the stock and other consideration involved in the transaction would equal or exceed 18 1/2 percent of the market value of the outstanding shares (NYSE Listed Company Manual, Section 312.00, Shareholder Approval Policy). However, the NYSE rules apply only to listed companies.

Recommendation. The NYSE's shareholder approval rule should be codified and made applicable to fundamental changes by all publicly-held corporations. Specifically, Congress should enact a statute which requires shareholder approval for the issuance of stock or securities convertible into stock if the issuance of such securities would increase the number of shares outstanding by 18 1/2 percent or more. Consideration should be given to a similar rule for asset lockups.

Comments. The purpose of the shareholder approval rule is to prevent shareholders from being disenfranchised by management. Without the rule, management of a company could defend against a takeover by issuing to itself or a friendly third party large amounts of additional common stock or options or warrants to purchase common stock. The issuance of additional stock dilutes the voting rights and possibly the value of outstanding shares. If sufficient stock is issued, it could effectively transfer control of a company from the shareholders to management or a friendly third party. The NYSE rule places an 18 1/2 percent cap on the amount of dilution, both in terms of the voting power and market value of the outstanding stock, which can take place without shareholder approval. This appears to be an appropriate limitation for a federal rule.

The rationale of the shareholder approval rule is equally applicable to sales of assets. In response to a takeover threat, a corporation's managers may agree to sell one of its "crown jewels" to a friendly third party to make itself less attractive to the bidder. Shareholders should be entitled to vote on such sales if they involve fundamental changes in the companies in which they have invested their money.

Finally, codifying the NYSE rule would create a level playing field for all corporations. Corporations which have securities listed for trading on the other stock exchanges or the National Association of Securities Dealers' "Over-the-Counter" quotation system should not have substantial advantages over NYSE-listed companies in terms of available defenses to takeover attempts. The effect of such disparate treatment would be to encourage companies to leave the NYSE to gain advantages in defending themselves from potential takeover attempts.

V. FINANCING TAKEOVERS

A. Limit Investment Discretion of Federally-Insured Institutions To Purchase Non-Investment Grade Debt

Current Law. Federally-chartered savings and loan associations ("S&Ls") are prohibited from investing more than 11 percent of their assets in non-investment grade bonds.

However, there is no overall cap on the percentage of assets of state-chartered, federally-insured S&Ls which can be invested in bonds. Thus, there is nothing in the federal law to prohibit a state-chartered S&L from investing 30 percent or even more of its assets in non-investment grade bonds.

Recommendation. Congress should enact a statute which imposes on state-chartered, federally-insured S&Ls the same portfolio limitations that have been placed on federally-chartered S&Ls.

Comments. There has been concern that federally-insured, state-chartered S&Ls are investing too much of their assets in non-investment grade bonds. This concern is legitimate. Although these bonds are attractive because of their high yields, they are by definition more risky than investment grade bonds. Because the federal government, and ultimately the taxpaying public, will ultimately guarantee any loss, the federal government has a legitimate interest in ensuring that state-chartered S&Ls with federal depository insurance do not take undue risks in the non-investment grade bond market. This concern is appropriately addressed by subjecting such S&Ls to the same investment limitations that are currently imposed on federally-chartered S&Ls.

However, the concern over imprudent concentrations of non-investment grade bonds in S&L portfolios is very different from a concern that too much non-investment graded debt is being issued in connection with takeovers, leveraged buy-outs, and other corporate reorganizations. There is no basis for this latter concern. The amount of debt that is appropriate for any corporation depends on the facts and circumstances. Many leveraged buy-outs financed with so-called junk bonds have been enormous successes. The bonds issued in these transactions are purchased by sophisticated institutional investors who are fully able to judge the risks and rewards of such investments. The federal government does not have the resources or expertise to determine which junk bond financings will be successful and which will be unsuccessful.

Moreover, in regulating this form of financing, Congress should have sensitivity to the fact that the so-called junk bond market has enabled numerous growth companies to gain access to the bond markets for the first time. These small companies, which are unable to obtain investment grade ratings for their bonds, play an important part in ensuring America's competitiveness.

Mr. GREENHILL. The other thing is that we see it in Minnesota today. We'll see it in 45 States tomorrow. Each State will have its own rules about how to conduct a tender offer and the market will just grind to a halt.

Senator CHAFEE. Could you stress the competitiveness point of how does that affect U.S. competitiveness, that if Mr. Greenhill wants to buy Gillette Co. he's hampered to some degree by Massachusetts law? What does that have to do with Morgan Stanley being more competitive in world markets? Because if Hanbro's or whoever in London wants to come over, they are hampered by the same restrictions, so what is the international competitiveness argument?

Mr. GREENHILL. I think, Senator, the way this can be analyzed is that what affects the cost of capital and the efficiency of the capital market and if indeed each State has the right to regulate the way in which a tender offer is conducted, what that means is a company goes to the national marketplace to borrow money to sell common stock, shareholders are all over the country, but when it comes to how that stock can be sold or control passed you've got to be confined to the rules of each individual State.

What that will do is raise the cost of capital, lower the efficiency of the U.S. capital market, and in the end, we're in a competitive world and, frankly, the cost of capital in this country is one of the competitive edges we have in our manufacturing business. We have large offices in Tokyo, large offices in London, and I can tell you that the U.S. capital market is the most cost efficient and makes a tremendous difference.

If what happens is we have 50 different takeover laws in this country, the capital market will slowly become kind of a State-by-State market and it will be very costly and ineffective in terms of cost of capital. That's what I was driving at in terms of the international cost effectiveness.

Senator CHAFEE. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Chafee.

Mr. Greenhill, yesterday the Chairman of the Council of Economic Advisers, Beryl Sprinkel, and the Acting Chairman of the SEC, Mr. Cox, both opposed the concept that's in the bill which you support of restricting creeping tender offers.

Now we have a difference in percentage of the stock. We make it 15. You make it 20 percent. But you disagree with the SEC and the Council of Economic Advisers which represents the administration and you agree with us on that, which is very welcome.

Will you tell me why? Mr. Bachmann, I'd like your answer to that, too.

DISAGREE WITH ADMINISTRATION VIEW

Mr. GREENHILL. Three years ago when I was on the blue ribbon committee of the SEC, on tender offers, I made the same proposal. The Capital Markets Group's proposal would require tender offers for acquisitions over 20 percent. The reason we have that point of view is that there is a percentage, Mr. Chairman, at which we think all shareholders should have a shot at the same price, and a fellow should not be able to step into the market and sweep up control of the company without offering a control premium to all shareholders.

It's a matter of judgment whether that threshold is 20 percent, 15 percent, or 5 percent. In our experience—and we've turned over information to your staff that indicates the ownership of American companies—and there are many, many companies that have important ownership in the 15, 16, 17 percent area—and we think there are perfectly ordinary reasons for having that level of ownership without going through the burdensome process of a full tender offer. It's a very expensive process. That's what led us to the 20 percent threshold, and that's why we disagree with Mr. Cox of the SEC.

The CHAIRMAN. Mr. Bachmann?

Mr. BACHMANN. Well, I think you can demonstrate looking at history that some investors are able to move much faster than others and our investors are disadvantaged when there are deals that go through and by the time it's really generally available they don't have the same offer. We want cash if the big boys get cash. We don't want paper and they get cash. So we feel that whether it's 15 or 20 percent, and I can't tell you exactly what the percentage should be, but we do suggest that that difference is slight from a philosophical standpoint, and we believe people should be treated alike.

The CHAIRMAN. Well, I want to commend both of you on your statesmanlike position, which means you agree with our bill. [Laughter.]

DEBT PROBLEM OF TAKEOVER COMPANY

I'd like to ask both you gentlemen to meet a problem which I think is probably the biggest problem of all in this whole area. The effect on the economy which troubles many of us is the enormous increase in debt, when a takeover is successful, when it's unsuccessful, and just because it's threatened.

A firm which is doing well, making money, investing in research development and manpower training, a firm of that kind is a target for takeover. It's likely to have a lot better future because of the investment it's made.

On the other hand, a firm which is loaded with debt and can't afford because of its service costs of the debt to make these investments is less likely to be taken over.

When there is a raid, the simplest defense, is to borrow money, as Unocal did, and use the money to buy its stock, bid up the price and put the price of the stock out of range of the raider.

Doesn't that bother you and what can we do about it?

Mr. GREENHILL. Mr. Chairman, I think I would have some differences with some of your assumptions. In my experience, sir, the companies that are very well managed and run their affairs well in fact are not the targets.

The CHAIRMAN. Now, Mr. Greenhill, you know the Lowenstein study. What did Lowenstein show? He showed that the firms that were taken over, by and large, had a better return on equity—16 percent return—compared to the rest of the stocks in the rest of the companies that were not taken over.

Mr. GREENHILL. I think perhaps the way Mr. Lowenstein and I might evaluate the effectiveness of the management of a company might be somewhat different, but let me go on.

The CHAIRMAN. Well, isn't that the bottom line, the return on equity?

Mr. GREENHILL. The bottom line at the end of the day is the stock price and how much do you as a shareholder over the longer term earn in terms of stock price, dividends, and other measures that relate to wealth enhancement.

The CHAIRMAN. Well, the stock price doesn't mean anything except the earnings that are behind it, right?

Mr. GREENHILL. No, sir, I don't agree with that. But let me answer your first question.

I think the issue of leverage in a company is a very serious issue and at the end of the day, if management overleverages itself, the market has a way of disciplining those managements. And you could well be right that today where the leverage is at a certain level, some think it's too high, some think it's not high enough, the market has a way of correcting it. If we enter a dramatic downturn, some of these companies are going to be in difficulty.

Senator, on the other hand, some of the companies have done very well with the leverage because what that leverage has done in some cases, it's put ownership in the hands of the management and employees. One of the things that's done—and I feel very strongly about this—most companies I know where the management has an important ownership stake in the company, people basically work very, very hard, and I believe in this and I believe leverage makes that possible. It also increases the risk and I know and you know that if you increase the risk, while you may increase rewards, you also increase the downside.

But I think that's one of the possibilities in our system.

The CHAIRMAN. Thank you, sir.

Senator Bond.

Senator BOND. Thank you, Mr. Chairman.

Yesterday we heard testimony from several witnesses that suggested that issues of corporate governance—and they were talking primarily about defensive tactics—should be regulated by States. And your answers to Senator Chafee's questions, I gather both of you suggest that really once it becomes a question of the free flow of funds in the capital market you think that those should be preempted by the Federal Government.

How do you draw the distinction? Where is the line between compensation, golden parachute, or other things that might be a poison pill? How do we know what we should regulate and what we should preempt and what we should leave to the States?

Mr. BACHMANN. I'm not an attorney, so I feel a little hesitant on this.

Senator BOND. Please, give us a financier's view of that. We'll ask the attorneys to figure it out if you can give us the guidelines.

GUIDELINES FOR LEGISLATION

Mr. BACHMANN. I think when you're dealing with stocks that are trading in national markets where you're asking investors around the United States to put their capital in a company, then I think that those are really interstate matters.

I think that there are other matters that are matters of organization and things like that that are State issues. So there is a difference.

But I think in the case of investments where you are appealing to national markets for capital, then I think that it's appropriate that there be a national guideline that applies rather than a crazy quilt of guidelines that are tailored to each peculiar situation.

Senator BOND. Mr. Greenhill, can you comment on that?

Mr. GREENHILL. I think that if a corporation is privately owned, I think it's perfectly appropriate to have the State regulate it 100 percent. If a corporation raises money inside a State subject only to an intrastate offering, that's a different issue.

When a corporation raises money from stockholders across the country, however, there should be national standards governing transactions in the company's stock, Congress has long recognized the importance of having an understandable national securities laws, governing our national securities market. Indeed, in the takeover area, the Williams Act was enacted in the 1960's as you know, and this has been pretty much the cornerstone by which these things have been governed.

And if what happens next is that each State is going to set its own takeover laws, in effect, this committee and this Congress are largely going to be irrelevant. Each company is going to have to deal with State legislature by State legislature 50 times. And, unfortunately, the capital markets of the world don't work that way. That's one of the threats we see facing the country right now with the Supreme Court decision. It's going to be a State-by-State situation.

Senator BOND. Well, I understand your concern with the specifics of perhaps the antitakeover law, but I might suggest to you the even greater danger is that the Federal Government will extend itself too far into corporate governance, and given the situation where a corporation is seeking money in the national securities market, can you give us a smell test you described earlier of some general guidelines by which this committee might propose to interfere with corporate governance at the State level? What's the guideline?

Mr. GREENHILL. I think one of the guidelines, Senator Bond, is if the issues relate to the control of the company and the securities markets, that's one of the things that I think is a perfectly proper thing for the Senate and the Congress to regulate.

If the matters are solely relating to the governing of the company, that's a different matter. And we've got a long history in this country of State charters.

Senator BOND. One of the questions again that we've touched on several times here today is whether takeovers actually are designed to improve management. Can you give us a better idea or analysis of that impact? We've had discussions of the Burlington

Industries takeover battle. What made that company subject to takeover?

Mr. **Greenhill**. Well, let me say I think the Senators know that Morgan Stanley was the buyer in effect, as of this morning; I think we've ended up being the party that organized the leveraged buyout of Burlington Industries, working with the management. So it's an exciting time to be here.

And I think it's a fair question as to why was Burlington Industries subject of a takeover in the first place? Why didn't the stock market adequately evaluate the business of Burlington Industries? I think one of the reasons is that Burlington is basically a collection of businesses, some of which are very fine and some of which have had difficulty, but it's very difficult for the stock market to deal with the conglomerate enterprise. And a raider or two raiders saw this as a target and they didn't step out to do it to improve management. I assure you of that. They stepped into the situation to make some money. And it turned out that, as a result of the process, the shareholders got paid a great deal of money and we have the opportunity to work with management to run the business in the future and we're very excited about it. But that really was what was behind it.

Senator **Bond**. Thank you, Mr. Greenhill.

Thank you, Mr. Chairman.

The **Chairman**. Senator Graham.

Senator **Graham**. No questions.

The **Chairman**. Senator Dodd.

Senator **Dodd**. Thank you, Mr. Chairman.

I apologize to our witnesses for arriving a bit late to hear all of your testimony and if you responded to this earlier just say so and then I will move on and pick up the answers later.

We obviously have the principal author of the bill here in our chairman and so I'm going to describe or give my interpretation of what I think the chairman and Senator Riegle's intent is here. If he disagrees with it I'll hear from him right away and you don't have to respond to the question. If I don't, then I'll ask you to respond.

It seems to me that if you had to describe what the chairman and Senator Riegle offered here is to slow down the process, to take a second look to make sure that what we're doing here is really not only in the best interest of business but in the best interest of the economy that is in no small measure affected by what goes on in the merger field.

And that notion of kind of slowing things down a bit that obviously involves an element of government regulation. What I'm trying to get at here, is it the fact that we're trying to add additional burdens through congressional action through the regulatory system of this country that is the source of the objection, or is it the fundamental notion here to kind of slow things down a bit so that we don't get the egregious—I think what most would agree, egregious hostile takeovers that have been harmful?

It seems to me what I'm hearing from the business community is, yes, that goes on. It's unfortunate. We don't agree with it. But in your effort to deal with some of those cases, you're really doing significant damage to those mergers which are very healthy for the country and the economy.

My sense is from Senator Proxmire and Senator Riegle that's not their intent here. They don't want to stop or hurt the healthy acquisition that really does improve a company that might otherwise have gone sour or belly-up.

So is there a fundamental problem with the slowdown notion or is it just the Federal Government's reaching into an area that historically the business community reacts negatively to, either way?

Mr. BACHMANN. I guess we feel that we have significant areas of agreement with the chairman and with this proposal. Certainly in principle. We've come up with some different numbers on some things, but the thrust would be similar.

Our view of this is, No. 1, fairness for the investor. We say investor protection. Fairness is really the word that perhaps would be more appropriate. And the other is to try and keep the relationship evenhanded between the management and the offeror in these situations and we can point to failed acquisitions; we can also point to some where it had exactly the opposite effect. Our thrust is to try and keep it as neutral as we can so that we don't favor one party or the other and where we put in these periods like 30 day periods they are really aimed at trying to give the investor time to react, not an unnecessary amount, but enough time that they can weigh things and arrive at their own conclusion.

Senator DODD. Which I presume you would support the idea that they ought to have that time?

Mr. BACHMANN. Yes.

Mr. GREENHILL. I would say, Senator Dodd, I think as we said before, we basically have the view that 30 calendar days is an adequate time for investors on the one hand to judge the offer and for the company on the other hand to organize defenses if that's appropriate for the offer. And anything going beyond that—and we've never seen any evidence to the contrary—really puts an impediment in the capital system and what that will do is very simply raise the cost of capital ultimately. One of the advantages, I pointed out before, this country has is a very effective capital market.

Senator DODD. Is there a notion to try to keep the parties equal here?

Mr. GREENHILL. Yes.

Senator DODD. The sense obviously with the Proxmire-Riegle bill is that the time element, one of the features of this bill, plays an important role in that equitable environment. At least that's an assumption. I'm saying an awful lot about your bill, Mr. Chairman, that you may not agree with. I'm not sure you would agree with what I've said in characterizing it as a way of slowing things down.

Do you agree with the notion that one of the ways to achieve that equitable relationship is to slow things down?

Mr. GREENHILL. No, sir, we do not. We think that tilts the balance basically in favor of the entrenched management and we think the present system—we have a position not dissimilar from the SEC position, that in effect the present time schedule, if it were lengthened to a 30-day calendar period, is perfectly adequate.

Senator DODD. All right. Your response to that, Mr. Bachmann?

Mr. **Bachmann**. I think 30 days is sufficient time, first of all, for the investors to be able to evaluate, but also for others to step forward. I'm not sure that adding beyond 30 days is going to bring new people into the transaction. That's more than 4 weeks.

Senator **Dodd**. Last, and my time has expired and I would just ask you for a thought or two and you may have responded and if you have, then don't bother. But have you made different recommendations this morning than what the bill proposes that would, in your opinion, create a more equitable environment in this merger area, which is what we're trying to do? As I understand what we are clearly trying to do, because remember it's been substantially the business community that has come to us on this asking for help. This is not a question where it's been Ralph Nader and others advocating and pushing. These are your peers that have been suggesting a significant difficulty here.

What would you recommend that we do in lieu of some of the things you're seeing that are harmful that would help create that equitable environment? If you've responded to that, I'll pick up the answer.

RECOMMENDATIONS

Mr. **Bachmann**. Well, I think that we, as an association, began a process in January which led to the Shapiro report, which were our recommendations. And we see numerous similarities. I don't know that they are identical, but they are close enough we can certainly embrace them. And yet we are certainly troubled by certain parts of the proposed legislation. The private right to action looks to us like just a spider web as far as an offeror moving forward. We see the ability of each State—the lack of a Federal preemption as a quagmire or a bog that can really have multiple effects which concern us. And those would be a couple of the issues. I'm looking at my list here.

I think the listing of contacts on financing can have a dampening effect, perhaps an unnecessarily dampening effect, and would be very difficult for us to enforce, to be able to say what happened when going back 90 days.

Mr. **Greenhill**. I think we have submitted a detailed statement point by point relating to the things we suggest.

Second, we submitted in advance of the chairman's bill background material to the majority and minority staffs that indicated what we thought some of the improvements that could be made would be.

And I think we summarized this morning that there are really three areas that cause us very grave concern, but I would hope that would all be on the record.

Senator **Dodd**. Thank you.

The **Chairman**. Senator Riegle.

Senator **Riegle**. Mr. Greenhill, you say in your testimony, "The goal of legislation should be to stop the abusive behavior without damaging the markets," which is precisly what we hope to do.

What do you consider the abuses to be?

Mr. **Greenhill**. Well, I think today—and, Senator Riegle, there are a number of areas. I think that the ability of a person to in effect get a leg up in a transaction by secret buying before having to file a 13(d) is an area which I think is an abuse. We face this in other transactions and I think that what we propose is a little different than the chairman's bill. We propose that before a bidder crosses 5 percent he must make a filing. The market has a way of adjusting the price instantaneously. That would make it impossible for a fellow to buy cheap stock. That's one thing.

Greenmail, poison pills, to us, the simple thing is to have a smell test. If the shareholders aren't asked for their vote on the matter, you've got to ask yourselves, step back and strap in, because something's fundamentally wrong here. And we wouldn't prohibit the adoption of these defenses just when a tender offer is in progress because, as we pointed out, you have 430 poison pills presently in place. Further, it's not enough to say, well, just wait until those cases with a tender offer is in process because what's going to happen is a company is going to put them in place before a tender offer is made.

We haven't mentioned this morning—I know it will come up in your other hearings—we basically subscribe to the one-share-one-vote principle and you're going to hear more about that. That is our basic underlying feeling. We think when you access the public market you undertake a responsibility to the people who gave you the money and you ought to go back and ask them before you undertake things that entrench management's control. From our point of view, it's about that simple.

Senator RIEGLE. Mr. Bachmann, what abuses do you see out there? Would they be the same ones and would you add any to that list?

Mr. BACHMANN. I think the whole idea of parking securities, of sweeping the street. What troubles me is when the individual investor is treated differently than these special groups or these special individuals that seem to lead such charmed lives, and we would like for the person that lives in Sault Ste. Marie to have the same opportunity as the person that's in Manhattan. We don't think that that's the case today. We think there are clear examples where it is not the case.

Senator RIEGLE. Now you both criticize the bill's restrictiveness on group activity. I'm wondering if each of you separately could give us suggested legislative language in that area and maybe do so—I don't want to be arbitrary on a date—as soon as possible.

Mr. GREENHILL. We will do it.

Mr. BACHMANN. We would be happy to.

Senator RIEGLE. But quite quickly could you do that?

Mr. BACHMANN. Yes.

Mr. GREENHILL. Yes.

Senator RIEGLE. All right. Very good. Now on a different subject for the moment, both of you have represented previously that you would support a clarification of laws on insider trading. Is that still your view? Mr. Greenhill, would you favor a clarification on insider trading?

Mr. GREENHILL. Yes, sir, we would.

Mr. BACHMANN. Yes.

Senator RIEGLE. Mr. Greenhill, representatives of the Capital Markets Group have indicated to the staff that the group might not be willing to testify on the subject, whereas the SIA has said that it would.

That's hearsay. I assume you would be willing to testify? I mean you or the group would be willing to testify?

Mr. GREENHILL. We'll do the best we can. We've been down here almost every week now and we're going to go to the House next week.

Senator RIEGLE. Well, you're a great witness.

In any event, we would very much like to get your thoughts on that because I think we are going to put a definition of insider trading in place. We're going to try very hard and I want us to do it right and so I want to make sure that we really have heard everybody and weighed it carefully so that we all can feel good about the result if we can accomplish it.

Mr. Bachmann, one other thing for you, and that is, putting aside your SIA hat for a minute, do you have any philosophic problems or doubts about some of the current takeover activity that's taking place and do you feel that there have been some examples where they have really worked in a way to have a destructive result and a harmful result? What's your view on that?

Mr. BACHMANN. I think any time you move into anecdotes you can give retrospective examples. If we want to deal in anecdotes, I think a very sad page in American corporate business which may turn out fine—it's too early to tell—is United Airlines. I mean, you talk about a peculiar series of events. That would be an example where it's not clear what happened, but it will become clear as the literature shows us, and I think there are other examples.

That's the difficulty. What I find, Senator, is when I start dealing in anecdotes, I look at the subject from one point of view and when I step back and look at it from the national perspective and from the investor's perspective and from a competitiveness perspective, I view it far differently. I think that's the basic dilemma that is faced in our country today. If we're dealing with a company in our community, to see their headquarters move elsewhere is difficult.

Senator RIEGLE. Let me just ask you one other thing if I may and that's this. We put the primary focus on value to shareholders and some people put all the focus on that and say that's really the only consideration and then it's a question of short term versus long term and so that discussion broadens out, too.

But as we look at this enormous increase in merger and takeover activity, is that the only test we should apply, in your professional view? Or what should be the issues that we try to weigh in determining, in a sense, what public policy ought to be here?

Mr. BACHMANN. I think that you have to look at multiple impacts. Today we're a pluralistic society. I have to speak from the standpoint of the shareholder and yet to ignore the fact that there are community impacts and that there are other impacts—such as the employees and the customers—there's a range of constituencies who can be served or misserved and the difficult task that you have is to try and balance those in a way that, on the one hand sees that people are treated fairly and, on the other hand, make certain that we remain competitive. I think—and I have to speak for the securities industry. We're going through such a tumultuous period of change and when you step back and look at internationalization and other issues, they are really driven by technology. The ability for the stock exchange to trade 60 million shares in one minute is a technological triumph. The fact that you can communicate around the world in fractions of a second has simply changed the world. As much as we might want to resist it, also as I say, your difficult job is to try, on the one hand, to recognize changes and look after our Nation's long-term interest while, at the same time, not grinding up our citizens in the process.

Senator RIEGLE. Mr. Greenhill, you wanted to make a point?

Mr. GREENHILL. Yes. These things are always difficult and I'm very partisan when it comes to this country. I have a lot of business around the world but basically I think it turns out we've got, as far as I'm concerned, the greatest country in the world and one of the parts of that is a capital market that provides very cost-effective capital to our industry. And when we compete with Germany or the U.K. or Japan, one of the tools we have is the cost-effective capital market.

I would suggest to you that one of the questions—and you face it every day because these are difficult choices—in a declining industry is how do you get the workers retrained to go into new industries. The task ought to be job creation on a national basis. And cost of capital is one of the elements that lets us create jobs on a national basis. And if we're not cost effective internationally, we're not going to be very competitive. This is one of our weapons. We don't have a lot of weapons. This is sure as heck one of them.

And as long as we put it in that perspective, what you want from his point of view, you want a market that treats investors fairly. From a broader public policy point of view, you want a market which basically supports the maximum job creation.

Senator RIEGLE. Thank you.

The CHAIRMAN. Thank you, Senator Riegle.

Senator Wirth.

Senator WIRTH. Thank you, Mr. Chairman.

Let me go back if I might to an issue I raised in previous hearings and again this morning, and that's the role of the States in all of this.

We are faced with, as you know, something of a political dilemma. On the one hand, I don't think that there are very many members of the committee who want to be in the position of saying to the States you don't have a role in this but, on the other hand, it's very clear that we're looking at a national marketplace and increasingly looking at a marketplace that has to compete internationally and you can't do that probably with a checkerboard or balkanization pattern of regulation.

We have historically left all of the issues of shareholder governance to the States to determine and so we have a long history in that particular area.

Earlier the discussion was what kind of guidelines would you set up for trying to sort your way through this political minefield. It seems to me that two of the themes that have come out of the discussions around this legislation and other discussions are: One, neutrality; and two, shareholder protection. And it seems to me that if we start with those trying to figure out a way to draw the line between the States and the Federal responsibility, that if we assume that those two basic principles of neutrality and shareholder protection are the ones that we ought to pursue, then you can build some specifics on top of that.

If you look at what's going on today, as I understand it, if we assume neutrality, that certainly is not the case when you look at a variety of State standards or State laws or regulations. They are not what anybody would suggest as being neutral.

If you look at the principle of shareholder protection and the assumption that shareholders ought to be able to make a choice between the raider or management, it's my understanding that a variety of State laws have in fact precluded the shareholders from having any voice at all.

Therefore, it seems to me obviating one of the basic themes of securities law that we have had for the last 50 years.

So building on those two, if those are two basic assumptions that we ought to be thinking about—neutrality and shareholder protection—I'm not sure that there's any disagreement on those or very much disagreement on those—could we then go on from there to establish some specific standards? For example, is one-share-one-vote a way of assuring shareholder protection and therefore a way of assuring that you don't have this maybe State moving in and violating the issue of neutrality?

Mr. **Greenhill**. It certainly is a start, Senator.

Senator **Wirth**. What are others that one might build? First of all, is that an appropriate foundation? And second, if it is, what are other specifics that might be built upon that? Does that question make sense?

Mr. **Greenhill**. Sure. I think you have been very eloquent. I think you've enunciated two principles that I certainly wouldn't disagree with. I would say another thought as a theme would be any elements that the corporation puts in place which basically wrests control from the shareholders ought to be devices that are put to a shareholder vote. It's about that simple. I don't think it's very complicated.

Senator **Wirth**. So would those be three pieces that you would write into the legislation?

Mr. **Greenhill**. Yes.

Senator **Wirth**. Again, where do you draw the line when someone is out of line?

Mr. **Greenhill**. I think that's enough.

Senator **Wirth**. You would say State law has got to be neutral? How would you go about doing that? Maybe, Mr. Bachmann, your legal beagles up there at SIA might give us a hand on that and try to figure out what the specific standards might be.

Mr. **Bachmann**. I think we can look at it. I can't give you a specific suggestion beyond what has just been stated.

Senator **Wirth**. Maybe that's a way to start and we might ask you to come back to us to help us perhaps better understand the ramifications of this. It's politically a very difficult issue and we have a long history of State responsibility for governance and I remember reading about the minds that blew up when we started the discussion in the 1960's of getting into federally chartering of corporations and so on and you know the top blew off, as it should have. That was a transgression I think into the jurisdiction of the States, but I think maybe there's been a transgression the other way and we've got to right that balance here.

Could we ask you, Mr. Bachmann, to come back with maybe the SIA's thoughts and maybe the Capital Markets Group's, Mr. Greenhill?

Mr. GREENHILL. Yes.

Mr. BACHMANN. We will try to provide something.

Senator WIRTH. I see my time has expired. If I might just ask one follow-up from the point of Mr. Riegle's question on insider trading, can you give us a sense of what the problems are with the current way of insider trading being defined through case law and so on? Has this provided problems for enforcement at the SEC or has this provided problems with you all in training your employees as to what's right and what's wrong?

Mr. GREENHILL. I don't think it's provided problems in training our employees. I think the point we make is that, if it's decided there's going to be a definition of insider trading, we would be very cautious about how it's done because, frankly, any time you put down a new definition you're going to have a whole series of court actions which will reinterpret the definition. We have basically supported the SEC's efforts to draw a fence around insider trading. We don't really think most people have much of a problem knowing what's right and what's wrong. That isn't what a lot of these newspaper stories are really about. What's right and what's wrong tends to be pretty clear. I'm sure there are gray edges.

But if you do decide, in this committee's wisdom and in the Congress' wisdom, to put in a definition of insider trading, we ask that you try to make it as clear as possible because our industry has enough problems with some of these gray edges.

Senator WIRTH. I am very skeptical as to whether we can do that and whether we should do that. It's a subject for another day I know.

Senator RIEGLE. Would you just yield for a moment on that?

Senator WIRTH. Yes.

Senator RIEGLE. We have a formal proposal from the Capital Markets Group to come up with a tighter definition of insider trading and it sounds to me like I'm hearing something different.

Mr. GREENHILL. No. We will stand behind that, but, Senator Riegle, we're cautious about this area. We are frankly very cautious. I don't want to say there's a magic solution to this. It's hard. This is a very difficult area.

Senator RIEGLE. But I take it, then, that the recommendation from the Capital Markets Group that in fact we go ahead in this area and try to better define insider trading is still the position? You're not changing that?

Mr. GREENHILL. No, we're not changing our position. We're just stating for this committee that we are cautious. We are very cautious.

Senator WIRTH. I'm not sure that's what I heard.

Mr. **Greenhill**. No. We made a proposal. We will stay with it. But I want you to know.

Senator **Wirth**. Let me see if I can restate for the record what I heard you say, that if the Congress in its wisdom decides to go ahead with a definition of insider trading, then you would stick by your proposal?

Mr. **Greenhill**. Yes.

Senator **Wirth**. But you're not sure that we ought to go over and make that first decision, is that correct, Mr. Greenhill? You're not sure. You're saying that if the Congress in its wisdom decides that it should do so, right?

Mr. **Greenhill**. I think that's fair and I think this is a difficult area.

Senator **Riegle**. But I think we'd better nail it down because——

Senator **Wirth**. I'm trying to do that.

Senator **Riegle**. Well, we really haven't because the proposal came before the legislation. We had a proposal from the Capital Markets Group suggesting that we move in this area and now we've developed a proposal.

Mr. **Greenhill**. We will do the best we can. We are going to stand by the proposal we made and one of the things I've observed——

Senator **Riegle**. The point is, you initiated the proposal and we've acted in response to it. And that is very different than the formulation that was just made here.

Mr. **Greenhill**. Senator, we will stand on what we said to you in writing, but I want to say I am very cautious about how this is implemented. I think that's enough. Each of you are very bright and you can ask a lot of different questions. In the area of how you define insider trading this is a very difficult area and we'll work with your staff.

Senator **Riegle**. I just don't want the impression left that we're off doing something that we haven't been asked by yourselves to undertake to do. In fact, we've got a proposal that's been sent to us that came before we drafted any legislation and I just don't want any confusion on that point because——

Mr. **Greenhill**. We're going to stick with it.

SHOULD CONGRESS DEFINE INSIDER TRADING

Senator **Wirth**. Mr. Chairman, I know my time has long expired, but I think the point that we're facing here, the fundamental decision that we have to make, is will the Congress exercise its wisdom and go ahead and define insider trading? And some of us are very skeptical about whether or not we should do that. That's the issue in front of us. If we do it, you all have been forthcoming, but I gather that there's a good deal of reluctance as to whether or not we should do that or stick with where we are now with a whole variety of case law. That's the fundamental decision that we have to make, Mr. Chairman. We have to get over that watershed first and I guess I've made my position on this ambiguously clear, that I'm not sure that we ought to do that. We've tried it in the past. I think we have the potential of giving an open-ended invitation to a lot of very smart lawyers to sneak around what we try to write into the statute and leaving it more flexible might serve shareholders and serve the economy in a better way.

Senator RIEGLE. Mr. Bachmann, might I ask your response on that? I take it we've also got a proposal from you to move in this area and I assume that there's a feeling—I assume that still stands, is that right?

Mr. BACHMANN. Senator, I thought you'd never ask. [Laughter.]

Yes, I stand behind that. We believe that there should be a definition of insider trading and I think we have spoken to you both by letter and otherwise. That was part of the finding of the Shapiro task force and it was endorsed by the board and you know we want to be a part of that process.

Senator RIEGLE. You will be. Thank you.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. I'd like to ask a question and then pursue some inquiries from Senator Wirth.

Later this week we're going to have a hearing on the specific topic of corporate takeovers in the environment of corporations which have a high degree of employee ownership, either the corporation that is the object of the acquisition or, in the United Airlines case, the potential acquiring corporation.

Do you have any comments as to whether there are any characteristics that apply in a takeover situation where one or the other of the parties has a high proportion of employee ownership that distinguishes that from corporate takeovers in any other circumstance?

Mr. GREENHILL. You mean those cases, Senator, where employees have a direct ownership stake in the business?

Senator GRAHAM. Either in the case of United as part of the acquiring group or, for instance, in the case of Eastern, as part of the group to be acquired.

Mr. GREENHILL. Our firm is involved in representing the directors of United, so I would prefer not to comment on that situation because we have a client relationship involved.

But in general, I favor those situations where employees have an important stake in the ownership, where management does. As I've seen it over and over again in front of boards of directors, when I looked at the board of directors and I'd ask each director how much do they own in the business, if the fellow is a college professor and whatever he owns is important to him, that's all I ask. But I think that's a very important step.

The second thing is I just believe that the businesses work better where the employees own the business.

Senator GRAHAM. The question is, in a corporate takeover situation, are there any considerations that should be taken into account that would differentiate from a standard takeover a takeover which involved on one side or the other of the acquisition a corporation with a high proportion of employee ownership?

Mr. GREENHILL. I don't think so. I think that basically employees typically don't have the money to put up and it's usually a leveraged transaction, but they have the basic ability to change the economics by changing their compensation. They change the underlying economics, and that's a very powerful stake.

Mr. BACHMANN. I can think of nothing.

Senator GRAHAM. I'd like to pursue the question of the State interest. It seems that using the term neutrality that one aspect of that neutrality is geographic neutrality. That is, that the Federal Government's role in the securities process should be one of a nationwide interest and not attempting to tilt toward any particular community, State or region, but let those decisions be made in the marketplace.

In contrast, States have a legitimate interest in their internal economic well being and I think this comes up in issues such as should we require an economic impact study of the effect of a takeover on the communities which are currently the host to that corporation or important parts of its activity.

I wonder if you could comment as to how, in sorting out Federal-State responsibilities, that distinction between geographic neutrality at the Federal level but recognizing the appropriateness and the political reality that there is going to be a geographical bias at the State level—how those might be reconciled?

Mr. BACHMANN. I think that this is a very difficult issue because what, on the one hand, can be in the short-term interest of the State in job creation can be in the long term a disadvantage. When you start distorting the message of the market, it can send the wrong signal. And the wrong signal can be the extension and creation and the poring of capital into a business that does not represent where the opportunities in the future are. And that's a great difficulty. How do you find the balance between local needs and the needs of the world. Whereas at one time people in your position probably saw the world as the United States of America, today we are no longer the leader in so many areas that you're not only balancing national issues but international issues with local issues, trying to keep our Nation competitive, and that's probably not a popular thing to do.

Senator GRAHAM. If I could just supplement my question and then maybe you could incorporate it into your response, how well does the market take into account those State-State differences? Senator Wirth was talking about States which have become very zealous in attempting to effect the neutrality primarily toward the status quo. Would a State situs of a corporation be a factor in how the marketplace would evaluate the shares of that corporation?

Mr. GREENHILL. I gather in Mr. Sprinkel's testimony of yesterday he suggested that there would be a competition among States and that companies incorporated in States which had restrictive takeover procedures would sell at discounts, and that would be a satisfactory control. I would say that that would not be a satisfactory control because the managements that choose to incorporate in those States themselves usually own a very small portion of the shares.

The second point on your economic impact statement is an issue which addresses not just takeovers but opening and closing of plants, opening and closing of headquarters, and in our view, should be removed from the securities legislation and, if addressed, ought to be addressed in a much broader context because it really has nothing to do with takeovers other than just basic economic activities. It's no easier if a plant is closed because of a takeover than if it gets closed because of a company's choice. That's a different issue. But if you put it in the takeover context, what's it going to be used for? Very simple. It will be used as a litigation component of management defense. It's almost just as sure as night follows day that's what is going to happen.

Senator **Graham**. Thank you.

The **Chairman**. Thank you very much.

Senator **Dodd**. Could I ask one thing. It's just a question but then suggest it's maybe something we want to look at. Your response may require more time than what we have left here for you this morning.

Senator Wirth, very properly and eloquently, talked about the themes here of neutrality and protection of shareholders and I think there's a presumption, at least on the part of some—I don't mean the witnesses, but there are probably those who are gathered here in the room here today who are so knowledgeable about this subject matter—but that the shareholder of today is vastly different than that one normally thinks about as a shareholder.

INSTITUTIONAL INVESTOR

I am told that by the year 2000 or thereabout that 50 percent of all corporate equity will be institutional investors. It seems to me that one of the things we ought to be looking at here is the institutional investor as opposed to the individual shareholder that we traditionally think of, and I know Senator Graham is going to hold some hearings I think this week on employee ownership and so forth, which is another set of questions, but I wonder if you might address that for a minute, the question of the institutional investor, and what are the obligations and what should we be looking at? That's a different investor, as I say, than the individual investor who plays the market and, in fact, the traditional notion that the institutional investor is that quick in and out operation, they're in for the fast dollar on these things, in fact I think recent studies or studies over the last 10 years or more have indicated that they have not outperformed the average Standard and Poor efforts in this area, the indexing. That is not the case. And yet we know that with pension funds there's a whole set of secondary issues that come into play here and I guess the question I'll just ask you is: one, should we be looking at that? And what should we be addressing ourselves to if we should look at that, the question of the institutional investor, the changing character of the shareholder?

Mr. **Greenhill**. I think in the institutional area you've seen a stock market which in the 1960's as you remember was basically where the individuals were a very important component of that market and that was increasing. Then the stock market went into a big decline in the late 1960's and early 1970's and all of a sudden the individual decided the stock market wasn't such a great place to be. They went into real estate. Inflation increased. The participation by institutions has continued to increase since then. And a lot of individuals decided they would rather let somebody else make those investment decisions.

I don't think the basic issues really are much different for the institutions than they are for the individual investors. I think it's going to run back to what constitutes an efficient capital market.

And the idea, Senator Dodd, that somebody can make a corporate decision for the long term and not for the short term or investment for the long term or short term, what you're doing is making an investment usually and you hope to make a profit on that investment. It may turn out that what you thought was a short-term investment ended up being a long-term investment and not by your own choosing. That's kind of a typical pattern when things go bad.

I don't really think there's much difference in institutions, but I would like to see, as just a private citizen, institutions make their position known much more strongly than they do. If a pension fund manager called up a corporation and said, "Look, we own 3 percent of your stock and basically we're against what you're doing," it would have tremendous power. They practically never do it. It's surprising, isn't it, with these great powerful institutions?

Senator DODD. Yes.

Mr. BACHMANN. Well, my concerns are certainly with the institution, because we all now have multiple ownership some way either through our profit-sharing plans or through other types of broad investments. But the main concern that I would express is for the individual investor to make certain that in this process the individual is not lost because today well over two-thirds of the shares owned in America, I believe, are owned by individuals. And while we see incredible activity in the market, that activity is a relatively small number of people just trading and trading and trading certain shares. So the individual investor would be easy at this point to take for granted or to lose sight of because he's not as organized and does not have a spokesmen.

Senator DODD. I didn't mean to say we're losing sight of that. Don't misunderstand me. But there is a changing environment out there.

Mr. BACHMANN. There's no question.

Senator DODD. Do you disagree with the prediction that by the year 2000 or thereabouts or before?

Mr. BACHMANN. Well, if you include mutual funds in this category, then you're probably there.

Senator DODD. It's already arrived. And would you agree with Mr. Greenhill that there probably is not a separate set of issues that we ought to be looking at with the institutional investor as opposed to the individual, that basically they are the same issues, or do you see any secondary set of issues that Congress ought to examine, given the changing profile, if you will, of the investor, the shareholder?

Mr. BACHMANN. I would need to think about that. I don't want to give you an answer now.

Senator DODD. Fine. I would appreciate it if you would get back to us on that one.

Thank you, Mr. Chairman.

The CHAIRMAN. Well, gentlemen, again, thank you. You're so good and you're so fascinating to members of this committee that we won't let you go, but we're going to let you go now. We have a very patient witness, a very fine witness, Laurence Gold, who's been waiting. Before you go, I want to leave one thought.

Financial World Magazine carries a feature called "Wall Street's Superstars." The caption reads "of the 100 highest paid people on

Wall Street, the top person made $125 million. The lowest $3 million. Merger and acquisition stars, leveraged buyout artists, and investment bankers top the list. Geoffrey Boisi and James Garter at Goldman Sachs reportedly made between $6.5 million and $9.7 million in 1986; Eric Gleacher at your own shop, Morgan Stanley, reportedly made between $3 and $5 million; Bruce Wasserstein and Joseph Perella at First Boston, knowledgeable investment bankers, placed their take at $5 to $6 million for Perella and close to $8 million for Wasserstein; and the list goes on and on. Michael Milken, well over $30 million; Asher Edelman, between $25 and $30 million. And those are 1 year compensation packages.

I figure, since the President of the United States makes $200,000, Milken and Edelman are making 150 times as much as the President. The question I think we ought to think about is, do these people do more productive action in 2 days than the President of the United States does in an entire year?

Now, as a Democrat, I think they probably do. [Laughter.]

This is a whale of a lot of money and I think if there's greed anywhere it appears to be in this area. It's something we have to be very troubled about.

Our next witness is Mr. Laurence Gold. Mr. Gold, bless your heart, you have the patience and I'm sure the wisdom of Solomon, so go right ahead.

STATEMENT OF LAURENCE GOLD, GENERAL COUNSEL, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. Gold. You are awfully kind, Mr. Chairman.

The Chairman. You've been here since 9:30. It's amazing.

Mr. Gold. And in light of the hour and your patience, I'd like to summarize our statement and then, if there are any questions, proceed.

[The complete prepared statement of Laurence Gold follows:]

offerors whose activities are deemed to be bona fide may open too wide a loophole.

3) The provision regulating the fairness of leveraged buyouts. There are inherent temptations in any self-dealing transaction and the modest prophylactic measures proposed in S. 1324 are necessary to protect against overreaching.

4) The provisions requiring "financing in place" and prohibiting hostile takeovers more than 25% of whose financing is secured against the target company's assets. These are plainly the minimum steps necessary to begin to deal with the problem of excessive leverage.

5) And, finally, the provisions prohibiting certain two-tier tender offers and the practice known as "sweeping the street".

S. 1323 as supplemented by the provisions of S. 1324 just outlined would, we believe, represent a marked improvement over current law.

There is, as I noted earlier, one aspect of S. 1323 and S. 1324 about which we are skeptical; both bills contain strong anti-preemption provisions authorizing each state to regulate "the internal affairs or governance of corporations" that are organized under the laws of that state. But state regulation which, in form, is of the "internal affairs" of corporate governance can, in practice, regulate the very matters regulated by the Williams Act. The labor movement's experience has led us to the conclusion that a sound and preemptive federal law regulating a single interstate transaction is superior to an approach based on divided federal-state regulation, with all the potential for conflict that such divided authority poses. We are unmoved by the fact that most lawyers and many others who delight in complexity and confusion for their own sake take a different view. We therefore believe that the end in view should be the best possible uniform federal system for regulating takeover activity, not the fragment of such a system to be supplemented here and there by competing or complementary state regulation. We look forward to working with the members of the Committee toward that goal.

The CHAIRMAN. Well, thank you very much, Mr. Gold, for an excellent statement. I think your suggestions are very good. We will be very receptive to the suggestions you make.

Your principal suggestions at the bottom of page 4 and page 5 include what's in the Sanford bill I take it?

Mr. GOLD. Yes. Each one of these provisions is in the Sanford bill and we regard each one of them as supplementary to S. 1323, not in any way in contradiction to the basic elements of S. 1323, all of which, as we note, we think are meritorious in their own right. These portions of S. 1324 broaden the focus to where it has to be, namely on the interests of all the constituencies of a corporation which is subject to a tender offer.

The corporation is made up not only of its stockholders, but also of those who are termed stakeholders; the people who have a long-term interest in the company and who have made a long-term investment in it, these include the employees, the communities in which the corporation's facilities are located and the rest. And we think that the points that are put on the table by Senator Sanford's bill are a valuable supplement to the focus of S. 1323.

The CHAIRMAN. I'm concerned about your views on States' rights. Yesterday we heard several State representatives who share your views on the havoc wrought by manipulative raiders. In affirming the right of States to control corporate governance, I think we'll be helping States promote their individual economies.

You seem to be skeptical about that and I understand that in some States you have reason to be. But by and large, I think the States have been very vigorous in trying to prevent destructive hostile corporate raids. Indiana was the most recent, in that respect, and that's the reason we provide in our bill a statement that we honor the right of the States to exercise their corporate governance which they have done traditionally throughout our history.

Mr. GOLD. I think this is a highly pragmatic judgment, just as I know from the opportunities we've had to work on this issue the judgments made in shaping S. 1323 were pragmatic. We can only list our priorities.

We are not blindly for preemption. We are for a sound, uniform bill, if that is possible, given the very tough political realities you just stated. We think the complexity and confusion of having these overlapping regimes isn't worth the cost. If your best judgment is that you're only going to take very limited steps, then we would not press the preemption point. We see preemption as complementary to Federal regulation to the extent that it's possible to balance out the interests at the Federal level. We think that it is better overall to have these transactions uniformly regulated. If only a part of the job can be done at the Federal level, then we would not be interested in preemption for its own sake.

The CHAIRMAN. Mr. Gold, this Friday we are holding a hearing on the role of employees and shareholders in takeovers. We will consider if any special provisions should be adopted to promote employees who are also shareholders.

RIGHTS OF EMPLOYEES

Let me ask you today, though, if you think there should be any special consideration of employees generally in a takeover? Should employees be given any special protection? For example, you endorse a community impact statement. What about a proposal requiring raiders to disclose if they expect to terminate workers or close plants?

Mr. GOLD. One of the protections in the community impact statement provided for in S. 1324 is just the information you've noted. In addition, as AFL-CIO Secretary-Treasurer Tom Donahue stressed in his testimony, we believe that employee protections over the transaction so that employees are not terminated willy-nilly by the new employer as is permissible under current law and so that collective bargaining agreements, for example, would be protected over the transaction, are very important.

Beyond that, I have to be frank to say that the AFL-CIO has no overall position on employee ownership as opposed to employee protections. Different of our affiliates take very different views on employee ownerships. Some believe that it is detrimental to the long-term interest of employees and others regard it as a positive good, and still others regard it as the best one can do in today's climate.

Thus with regard to the question of whether bidders who are bidding on behalf of employee groups ought to be specially treated, we simply have no position.

The CHAIRMAN. Senator Riegle.

Senator RIEGLE. Thank you, Mr. Chairman.

I think this is a very important discussion and I appreciate the presentation and the part of the record that it helps us build.

One of the things that we don't have that we need is better data on the job impact of the explosion of mergers and takeovers that we've seen and it would be a great help to us if you could undertake to try to assemble what data can be assembled to show what the net job impact has been, not only in terms of numbers of jobs, but if there's any way we can sort of take a look, at qualitatively, what kinds of jobs are we talking about or what kinds of level of income and what's happening here.

In a sense, it's a critical part of the debate but it's under-illuminated. We don't really have a very good handle on this and, frankly, we don't have an administration with a very great interest in wanting to assemble that kind of information.

But if you could do that, it would be very helpful to us and as you were sitting here this morning I'm sure you heard Mr. Greenhill say that in terms of his view of what the broad test should be as to the public interest aspect, he mentioned job creation. And that doesn't sound to me so far away from what George Meany, if he were still alive, or if Lane Kirkland were here, might have said or might say today; and that is, job creation is the bottom line.

Now I think that if we were to get into an elaborate discussion, maybe it's even more than that. It's what we do with the hours of labor, what are we producing, what are we making, how close does it come to what we need in terms of our standard of living, what are the conditions under which it's done and so forth. So there's a whole dimension beyond just a "job" that is really probably the bottom line, if you will.

But it struck me that there may be a basis here for a way of beginning to conceptualize what we're going to need in the future here that doesn't necessarily split off the component parts of our economy, with the capital markets people going in one direction and the labor movement going in a different direction and others going in still a different direction. Obviously, in the end, if we're going to get very far, we're going to have to have some sort of consensus view as to how we move forward in the sense that's fair and good for everybody.

I must tell you, as I read the front of the Wall Street Journal today in terms of the new debtor nation data that is out with the United States now almost nearly doubling our international debt, going way, way beyond anybody else, and the whole danger that that poses in terms of how we reverse those trend lines and does it just mean stripping our standard of living, which is what the economists tell us is the adjustment mechanism, so in any event, all of these things it seems to me tie together.

But if you could give us some data on the job impact in as complete a way as you can assemble it, that would be very helpful to us.

Mr. Gold. Let me say two things about the data and the point you made about the testimony that preceded ours.

In the prior hearing before the committee, we attempted to provide you with data coming out of mergers and acquisitions that affect organized employees. It's very difficult for us to get even that and almost impossible to go beyond that to situations which basically affect unorganized employees. One of the tragedies of dismantling the Government the way this administration has done in the past 8 years is that when you make these requests for information which the Government ought to be able to provide because it is the wellspring of intelligent legislative activity the Labor Department cannot give you anything that isn't fragmentary and when you read testimony like Mr. Sprinkel's isn't fiction.

The second point I want to make is that we have found these hearings to be highly educational. We don't come to this discussion with the view, as we've made plain in the testimony, that there ought to be an end to takeover activity or even hostile takeover activity. We do believe that the balance of regulating this takeover activity ought to take into account the variety of interests involved, the balance between stability and change, and ought to, as both you and the chairman have stressed, recognize that this new second market in corporate control is a highly artificial one which is created by people who have an incentive to make the kinds of money on the turnover that the chairman has alluded to, and that there has to be a way of controlling that aspect of the market without harming the overall capital markets.

There were many things that I heard the Capital Markets Group say with which we can agree within the limits that I've just stated and I thought their testimony was, overall, encouraging.

Senator Riegle. Thank you.

The Chairman. Thank you very, very much, Mr. Gold. We very much appreciate your testimony and your extraordinary patience.

The committee will stand in recess until tomorrow at 10 o'clock.

[Whereupon, at 12:25 p.m., the hearing was adjourned.]

REGULATING HOSTILE CORPORATE TAKEOVERS

THURSDAY, JUNE 25, 1987

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10 a.m., in room SD-538, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Riegle, Dixon, Sanford, Graham, Wirth, Garn, Heinz, Armstrong, D'Amato, Hecht, and Bond.

Also present: Senator Domenici.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

Welcome to this the third day of legislative testimony on tender offer reform legislation.

What we have heard in the last couple of days has been encouraging. Administration representative Beryl Sprinkel, who is Chairman of the Council of Economic Advisers, blasted our efforts, which I think means we must be on the right track. Investment bankers endorsed our aim at reforming tender offer law, accepting in principle many of the specific measures in our bill. State groups and labor representatives encouraged us to strengthen the measures in our package.

Today, we hear from representatives of those who manage corporations and from their bosses—major shareholders of those corporations. We have already heard from managers this year when 16 chief executive officers of important American companies described how manipulative, hostile raids have diverted management attention and financial resources into unproductive defensive tactics.

In testimony today we will also hear from institutional investors and shareholder groups. I expect that they complain about some defensive tactics, such as poison pills and greenmail. From both groups, I also expect to hear just how effective our provisions will and should be in preventing abuses by raiders.

There is no question that Congress must act. Other solutions have simply not worked. Despite the vocal protests of workers, productive operations continue to be plundered. Despite the economic threat of excessive leverage, our corporations have loaded up with unprecedented levels of debt. Certainly the promise of congressional action is not enough. In the time key Banking Committee members drafted and introduced this tender offer reform bill, look at

NO. 87-32

TESTIMONY OF LAURENCE GOLD, GENERAL COUNSEL, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS ON CORPORATE TAKEOVERS AND REORGANIZATIONS

June 24, 1987

The American Federation of Labor and Congress of Industrial Organizations, on behalf of its affiliated national and international unions and their 13,000,000 members, appreciates this opportunity to participate in the continuing discussion and debate on how to regulate corporate takeovers and reorganizations in the public interest. Since we last appeared before the Committee, S. 1323, the Tender Offer Disclosure and Fairness Act, has been introduced by the Chairman and Senator Riegle, and S. 1324, the Corporate Takeover and Insider Abuse Reform Act of 1987, introduced by Senator Sanford. These bills constitute thoughtful, comprehensive responses to the range of issues presented and we are pleased to be able to comment on their provisions.

It facilitates analysis to begin by reiterating the labor movement's interests and concerns with regard to takeover activity.

First of all we start from the basic premise stated by the Chairman in introducing S. 1323: the principal aim of federal regulation in this area should be to "curb manipulators whose purpose is to put companies into play in order to make a fast buck."

Secondly, it is our view that it is a fatal mistake to look at this problem as one affecting investors and stockholders alone. Takeover activity also directly and immediately affects the interests of the target corporation's employees and of the communities in which that corporation operates.

It is common ground, I believe, that it is neither sound nor feasible to forbid hostile takeovers or takeover activity generally. And a good deal of ingenuity has been expended without visible results in attempting to devise a litmus test to separate "good" merger and

acquisition activity from "bad" activity.

Against that background, the basic question before the Committee, as we see the matter, is whether steps to stabilize the market in corporate control by placing limits on highly speculative activities are warranted. It is our view that the answer to this question is "yes".

The common sense of the situation, as we noted in our earlier testimony, is that

> [T]oday's hostile takeover is qualitatively different from the takeover attempts of the past. In prior years, tender offers were initiated by financially secure, stable companies desiring to grow or to enter a new market by acquiring and operating some existing business. "What is completely different now," as *Business Week* puts it, "is that corporate restructuring is completely finance-driven." Today's raiders have neither financial strength nor managerial achievement; they are stock-market operators, and, along with their associated arbitrageurs and investment bankers, are generating deals not because of any desire to operate the target but rather simply to profit from the deal itself. And profit they do. For example, the investment banking firm of Drexel Burnham is estimated to have earned $1.5 billion in *profits* in 1986 -- close to a 100% return on capital.

A market made and controlled by those who do deals to make a living -- and who must therefore have deals to do -- is, in the nature of things, likely to be artificially inflated and excessively volatile.

It is, moreover, inherently unlikely that the real costs of these deals in time, effort and money expended will be repaid with a dividend in the production of better, less expensive, goods and services. There is no need to deny, or to denigrate in any way, the value of creative, innovative financing. But it strains reason to the breaking point to believe that, more often than not, rearranging the pieces of a corporation, or substituting one set of professional managers for another, at a substantial premium over the base market price of the corporation's stock, is likely to bring equal increases in quality and productivity. Akio Morita, Chairman of the Sony Corporation, shares our doubts on that score:

> American industry is now being distracted by a game called mergers and acquisitions. America's brightest managerial talent is engaged in takeover moves and empire-building. The best students do not study

> engineering but become MBA's or lawyers and, eventually, professional money makers. This is not a productive enterprise.
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> America must return to fundamentals, to making things of real value. ... A nation's economy is only as strong as its manufacturing base, and this base is chipped away by every mindless merger and by every decision to shift production to a newly developed country only to save on labor. [New York Times, June 6, 1987.]

As Mr. Morita also states, "A business organization's real asset is its people -- their good will, their energy and their creativity. But how can you expect your people to be motivated to work when they are traded like merchandise?" Thus, even if there is more magic in restructuring than we believe, and a perfectly free market in corporate control is best for shareholders and investors, the minimum requirement for a rational system of takeover regulation is protections for the interests and expectancies of employees and of the communities in which they live, work, build their homes and raise their children.

Given our premises, the AFL-CIO regards S. 1323 as a constructive, but far too modest, step forward. With one exception, which I shall develop at the end of my testimony, we support all the provisions of the bill. S. 1323 deals with the generally recognized infirmities in the Williams Act in a sensible fashion. The reforms it would work go a long way toward creating a system that is fairer for stockholders and investors. In so doing, the bill gets at a number of the most apparent and abhorrent manipulative techniques; to that extent, it should tend to cool this overheated market.

We have no pretensions, however, as to our expertise on the interests of shareholders and investors or on the best methods for protecting those interests. Our concerns are with the employees of companies which are engaged in, or subject to, takeover activity, and with the economic health of the system for producing goods and services. From our perspective, then, in two fundamental respects S. 1323 does not go far enough.

First, and foremost, S. 1323 does not provide any protection against the dislocations that follow once a company is put in play and, one way or another, emerges in a more

highly leveraged position. In our earlier testimony we detailed the steps we believe are needed to protect the employees of acquired companies and the communities in which such companies are located; I shall not burden the Committee by repeating our suggestions here. Second, S. 1323 does not provide enough in the way of disincentives to the making of "completely finance-driven" deals. The bill's reform of the Williams Act procedures, the tighter regulation of group activity, the ban on greenmail, the flexibility accorded fiduciaries, and the protection of pension funds are all helpful. But the only social good that anyone claims for the market in corporate control is better corporate management. And only those who provide that social good should reap a profit from tender offer activity. Yet, under S. 1323, there is still enormous room to make enormous profits by speculating on a company in play. So long as that remains true, it is more likely than not that such speculation will continue unabated.

For the reasons already given, we therefore commend to the Committee's attention in particular the following provisions put forward in S. 1324, introduced by Senator Sanford, all of which we support:

1) The provision requiring bidders to file an economic impact statement disclosing plans to close plants and other facilities, terminate employees, and abide by collective bargaining agreements, as well as list the assets and liabilities of the acquiring company and the extent to which the assets of the acquired company will be pledged or used in any way to finance the transaction. This information is the minimum employees and other stockholders in the corporation need to assess their situation and to determine how to advance and protect their interests.

2) The provision requiring the disgorgement of short-wing profits in the target company's stock realized by a person who makes an unsuccessful tender offer. We know of no other proposal that provides any realistic hope of limiting the ability of professional investors to manipulate the market. Indeed, we are concerned that S. 1324 does not go far enough and that its exemption in the event of a superior competing offer for tender

the spate of hostile raids. The Hafts attacked Dayton Hudson. British Printing took a stab at Harcourt. Asher Edelman allegedly exploited insider information to raid Burlington Industries, and WPP is swooping after J. Walter Thompson.

The market won't discipline these raiders. Scandal certainly doesn't seem to be stopping them. And cajoling by lawmakers isn't working either.

It's time for Congress to do more than talk. It's time to act.

We are looking forward to testimony this morning from excellent panels of witnesses including Pete Dominici, who we hope will be here shortly.

Senator Garn.

Senator Garn. Mr. Chairman, I have no opening statement today.

The Chairman. I have statements of Senators Dixon, Sasser, and Sanford that will be placed in the record.

STATEMENT OF SENATOR ALAN DIXON

Senator Dixon. Mr. Chairman, I am pleased to be here this morning as the Banking Committee conducts its third day of hearings on S. 1323, the Tender Offer Disclosure and Fairness Act, and other takeover reform legislation.

I believe reform is essential. Most of our securities laws were written at a time when most stock was owned by individuals. Now almost half of all stock is in the hands of professional managers of pension funds, mutual funds, and insurance companies, to cite three major examples. These managers are highly competent, but they do not own the stock, and the way they think about the market is different. Further, institutional ownership makes it possible for huge numbers of shares of a given company to move through the financial markets very quickly. It increases market liquidity, which is good. However, it may also tend to shorten the financial market's time horizon, focusing on a company's short-term outlook, rather than on its long-term prospects. There seems to be an ever-growing interest in trading, rather than in investing. Our securities laws, particularly in the takeover area, need to take these structural changes into account.

I look forward to hearing from this morning's witnesses. I'm sure their testimony will be of great value to the committee as we attempt to reach a consensus on tender offer reform legislation.

STATEMENT OF SENATOR JIM SASSER

Senator Sasser. Mr. Chairman, I am pleased to be here at the third of a series of hearings on the subject of legislation to address the regulation of corporate takeovers. This is one of the most critical economic and social issues facing Congress today.

Yesterday, we heard from representatives of the investment banking industry and of organized labor. Today we hear from business.

I was struck by a quotation contained in labor's testimony yesterday. It was an excerpt from a speech by the president of Sony Corp. Briefly, he said that America is distracted by a game called mergers and acquisitions. Our best talent is going into this. He said its not a productive enterprise and that we must return to fundamentals. He said:

> A nation's economy is only as strong as its manufacturing base, and this base is being chipped away by every mindless merger.

Today, as we begin floor debate on the trade bill. I am reminded that we have much to learn from our trade partners. There is much we can do at home to ensure a better use of our resources. Thank you, Mr. Chairman.

OPENING STATEMENT OF SENATOR TERRY SANFORD

Senator SANFORD. Mr. Chairman, I would like to begin by welcoming our distinguished witnesses. I appreciate their taking the time to appear at these hearings on corporate takeovers and I look forward to hearing the views of our corporate and investor representatives on the takeover bills before the committee. I should also mention that I was especially impressed by the substantial testimony submitted by Mr. Atwater. I read this document with great interest and while I hope, Mr. Atwater, that you are not inclined to read this testimony to us today in its entirety, I feel that your printed statement properly focuses from the very beginning on the core issue of concern in this whole takeover matter: How can we legislate a stop to the abusive actions of short-term-profit-driven market manipulators without obstructing the generally legitimate right of companies to take over other companies?

My colleagues, Senators Proxmire and Riegle, have a bill before this committee which I feel addresses quite effectively most of my concerns regarding abuses in the takeover arena. However, I have put forward a bill that I believe addresses three additional and essential problems. My first proposal would require raiders to return short swing profits earned in manipulative takeover attempts in much the same way that current SEC rules require the return of insider trading profits earned by individuals. My second proposal places leverage restrictions on a bidder if that bidder intended to use takeover debt secured by the assets on the balance sheet of a target company; such a bidder could only secure 25 percent of his total takeover debt using target company assets. Finally, under my bill, no raider could tender for a company without having his financing already committed by lenders. I firmly believe that passage of a bill without these additional provisions will place potential target companies in an even more vulnerable position than they currently find themselves.

I thank the committee for allowing me to present this statement and I look forward to hearing the witnesses comments on my proposals.

The CHAIRMAN. Unless Senator Domenici has appeared without our knowing it, we will proceed with the first panel. Mr. Atwater, Task Force on Corporate Responsibility of the Business Roundtable; Mr. Alexander Trowbridge, president of the National Association of Manufacturers; and Mr. Donald Clark, representing Stakeholders in America.

Mr. Atwater, if you would sit right here and, Mr. Trowbridge, at the next seat, and then Mr. Clark at the third seat.

The fourth seat is reserved for Senator Domenici if he shows up. We don't know if he's going to come or not.

Mr. Atwater, will you proceed, sir.

STATEMENT OF H. BREWSTER ATWATER, JR., TASK FORCE ON CORPORATE RESPONSIBILITY, THE BUSINESS ROUNDTABLE

Mr. ATWATER. Thank you very much, Mr. Chairman.

I do have a detailed statement which I would like to submit for the record if I might.

The CHAIRMAN. Without objection, it will be printed in full in the record. Thank you very much.

BASIC POLICY QUESTIONS

Mr. ATWATER. My testimony this morning is going to attempt to deal with just three basic policy questions. These questions are: First, is there really a problem affecting the U.S. economy in the current takeover process? Second, what are the specific elements in the takeover process which are causing these problems? Third, what can be done to correct these problems without in any way interfering with legitimate hostile takeovers?

The evidence is all around us that there is something wrong in the takeover process. Companies are being put into play by raiders who do not want to operate those companies. The raiders claim to build economic value by running companies better than incumbent management. In actuality, they make huge short-term profits by selling their shares back to the company or to a third party and never run the company.

For example, we studied 19 recent takeover attempts by raiders. All were unsuccessful in taking over the company, but provided these raiders with nearly a billion and a half dollars in profit, or an average of $77 million per deal. These huge short-term profits do not build long-term wealth in our economy.

The huge short-term profits that the raiders are making are not creating wealth in our society, but they represent a shifting of wealth from one set of stakeholders to another. This is a very important chart that shows how that happens.

ANATOMY OF A MANIPULATION

Step 1 -- A raider, some arbitrageurs and an investment banker who acts as coordinator, each take a position of less than 5% in a company. Because 5% is the SEC reporting threshold, the activity goes undetected, even though their collective holdings may exceed 20%.

Step 2 -- Rumors are started that the company is in play. To give the rumors substance, participants trade the stock back and forth to create the impression of heavy activity.

Step 3 -- A friendly stock analyst publishes a report giving the target company a very high breakup value. The target company becomes apprehensive and defensive.

Step 4 -- One or more of the participants approaches the target company and tries to make an immediate profit through greenmail or a leveraged buyout.

Step 5 -- The investment bank managing the raider's activity urges other corporations to make an offer for the target.

Step 6 -- Another company makes an offer, the target is acquired and the raider's group pockets its profits and leaves the scene.

Step 7 -- If the target is not acquired, the investment banker brings in a well-known raider to make a public offer for the company.

Step 8 -- Under great pressure, the target is forced to pay greenmail, execute a leveraged buyout, seek a "white knight," restructure, sell assets, or take on debt to make the company unattractive. The raider group pockets its profits.

Specifically, the raider's profit is made at the expense of uninformed shareholders, who are in the right-hand corner there, who sell their shares out at a lower price before the raid begins and they know what's going on. Raider's profits also come from bondholders who see the price of their bonds plunge as corporations are more heavily leveraged. The final losers are all the other stakeholders in the company, at the bottom here. They lose as payrolls, charitable contributions, research and development, and other expenses are slashed to provide funds for debt service.

A case in point is unfolding in my own city and you mentioned it this morning, Mr. Chairman. It's Dayton Hudson.

Dayton Hudson is one of Minnesota's largest and best-run companies and yet they are under attack by the Haft family. It is also a very large company with sales of $9 billion.

The company is widely admired for its superb management and corporate responsibility. They have had a very good growth record and sustained profitability. I guess the one thing you can't say about Dayton Hudson is that they have incompetent management.

For the past 41 years they have contributed 5 percent of their pretax earnings to charity. Last year that amounted to $20.8 million and almost half of it went to organizations in Minnesota. If they were to be broken up or highly leveraged, one of the very first things to go would be these charitable contributions. If that happened, the impact would be devastating. Cultural organizations in our city would be dealt a financial body blow. I think some would go under, and it would take many years to recover.

Now let's take a look at the Hafts. Last year, their family business did $367 million in sales, or about 4 percent of Dayton Hudson's, yet they claim they want to buy a company 25 times their size. Now that is the last thing they actually want to do. They do not want to operate Dayton Hudson. What they want to do is put the company into play and hope that the threat of a takeover by themselves or by somebody else will unnerve the management and cause them to pay greenmail or to restructure the company.

That's been their pattern in the other takeover attempts that the Hafts have made on Supermarkets General and Safeway, who are two of our major customers, and the May Department Stores and to Jack Eckerd. It is a greenmail game.

So we've got a lot of evidence that something is wrong in the takeover process. The next question is, what specifically in the process is causing these problems?

I've put together a diagram showing how this game is played and I think this will point out where the problems are.

HOW THE GAME IS PLAYED

It starts in step one with a coordinator, generally an investment banker, working with a number of arbs, pension funds, and raiders, each of whom take a position less than the current Williams Act requirements of 4.9 percent. With four or five raiders you can then get as much as 20 percent of the shares secretly bought before anybody knows about it.

The next step is to start rumors, accelerate the trading, somebody on the other side of the Chinese wall puts out a breakup value report. This all to sensitize the target company to the next step.

The next step is page 4, and what happens here is the target is approached and told you are going to be taken over, there is 20 percent of your stock outstanding, unless you pay greenmail or restructure your company in some way. If the target gets panicked and does that, the raiders cash out. They never have to run the company and they make huge quantities of money in a very short time.

If they refuse, step five is to try to get other large companies like ourselves or other people to try and make an all-cash offer. An all-cash offer for 100 percent of the stock always works and, again, the raiders get paid out.

If that doesn't work, they go to step seven, and step seven is when the raider comes into the game. He tends to make a partial offer and that partial offer is enormously coercive. The target is then in play and there are five or six possibilities there, which are white knights, greenmail, LBO's or so forth, and the group cashes out. This is what happens.

So the specific problems we feel are in steps one and step seven and those are the things that we think should be best addressed by your bill.

So that brings us to the third question. What can be done to correct these problems without in any way interfering with legitimate hostile takeovers?

Lowering the 13(d) threshold to 2 percent and closing the 10-day window prevents the kind of collaboration that we showed in step one that allows this loosely coordinated group to get up to 20 percent of the stock secretly.

We also think institutional investors are sometimes part of these manipulations and we think it's important to make sure that they have to report holdings in the same fashion as others. Under today's rules, institutional investors' positions can go unreported for months.

Furthermore, institutional investors regularly ask for and receive confidential treatment of their reports from the SEC.

S. 1323 requires disclosure of contacts between persons filing 13(d) reports and we think this would be very helpful, Mr. Chairman, in uncovering the collusive activity which is so hard for the SEC to uncover today.

Finally, private rights of action is a strong enforcement mechanism which could be made even stronger if stiff penalties were included for false or delinquent filings.

The step of this manipulation game that S. 1323 fails to address is step seven, which is a partial tender which leaves shareholders very little choice but to tender into the offer. The partial tender offer is a way of forcing shareholders to give you control of their company without having to pay them full value of the control premium that they are entitled to. It also allows a person or company with limited financial resources to gain control of the assets of a much bigger company, i.e. the Hafts, and then liquidate most of them in order to pay off the debt incurred in financing the deal.

This is a major weakness in the current regulatory system and yet the fix is relatively simple. You simply add a requirement that tender offers for more than 15 or 20 percent of a company's shares be for any or all of the outstanding shares. This gives shareholders equal footing and sharply curtails the abusive bustup takeover.

It's worth noting that 87 percent of all acquisitions are for any and all of the shares within 12 months and that well over 95 percent of the dollar value of acquisitions is for any and all. The point here is that this provision would in no way limit legitimate takeover activities since almost all of these are for 100 percent.

In fact, any investor who feels he can run a company better than the incumbent management wants to own 100 percent of the company so that he can institute his new management without concerns about minority shareholders. This is certainly the case with our company and we have made over 50 acquisitions.

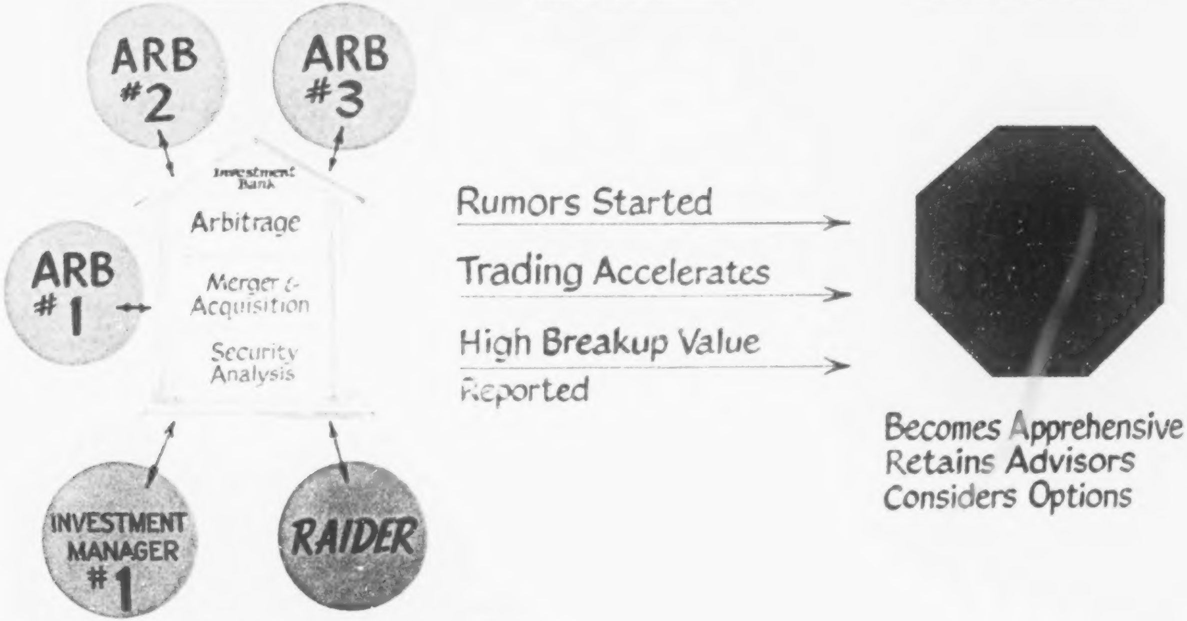
The clear sign of a manipulation is when the acquiring party makes a conditional or front-end loaded partial offer.

Finally, I want to underscore the importance of the language in S. 1323 affirming the traditional role of States in regulating corporate governance and internal affairs. I cover this subject in detail in my prepared remarks and simply wanted to express orally how vital this provision is.

Mr. Chairman, I want to thank you and the other members of the committee for this opportunity to share our thoughts with you.

[The complete prepared statement of H.B. Atwater follows:]

ANATOMY OF A MANIPULATION



STEP 1

ARB #2

ARB #3

Investment Bank

Arbitrage

Merger & Acquisition

Security Analysis

ARB #1

INVESTMENT MANAGER #1

RAIDER

Each secretly accumulates up to 4.9% positions in target

STEP 2

Rumors Started →

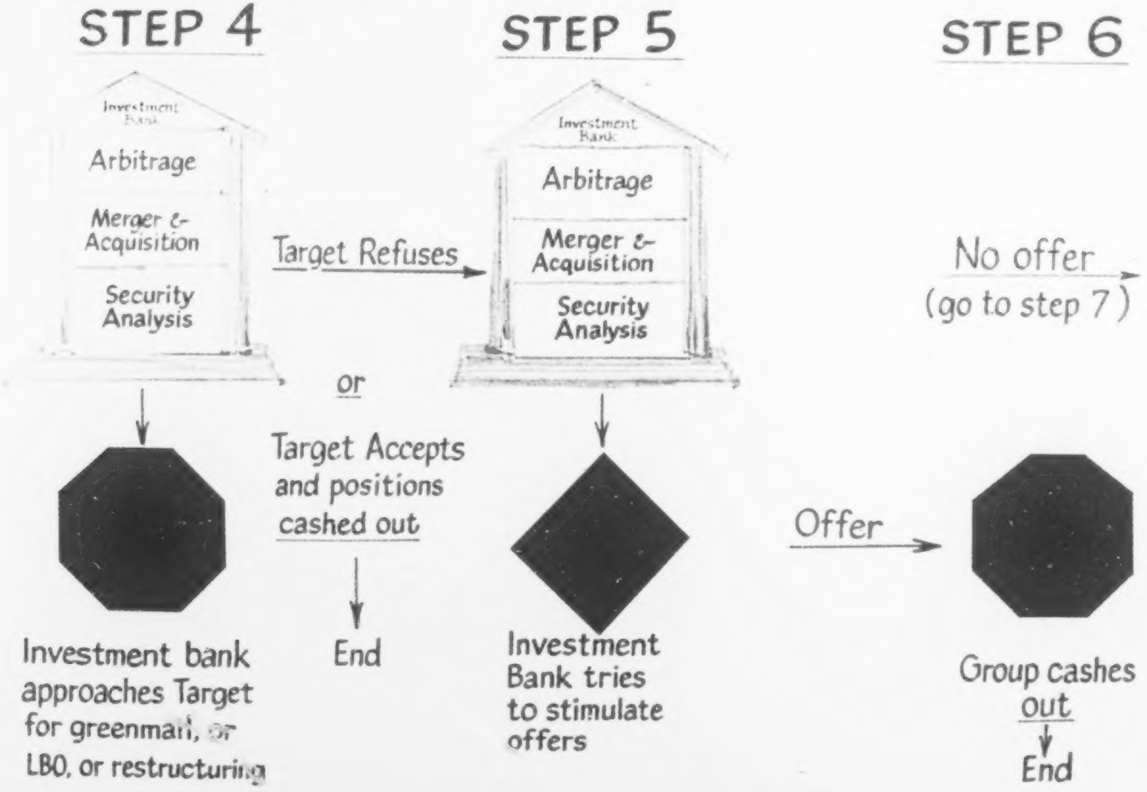
Trading Accelerates →

High Breakup Value Reported →

STEP 3

Becomes Apprehensive
Retains Advisors
Considers Options

ANATOMY OF A MANIPULATION



STEP 4

Investment Bank

Arbitrage

Merger & Acquisition

Security Analysis

Investment bank approaches Target for greenmail, or LBO, or restructuring

Target Refuses

or

Target Accepts and positions cashed out

End

STEP 5

Investment Bank

Arbitrage

Merger & Acquisition

Security Analysis

Investment Bank tries to stimulate offers

STEP 6

No offer (go to step 7)

Offer

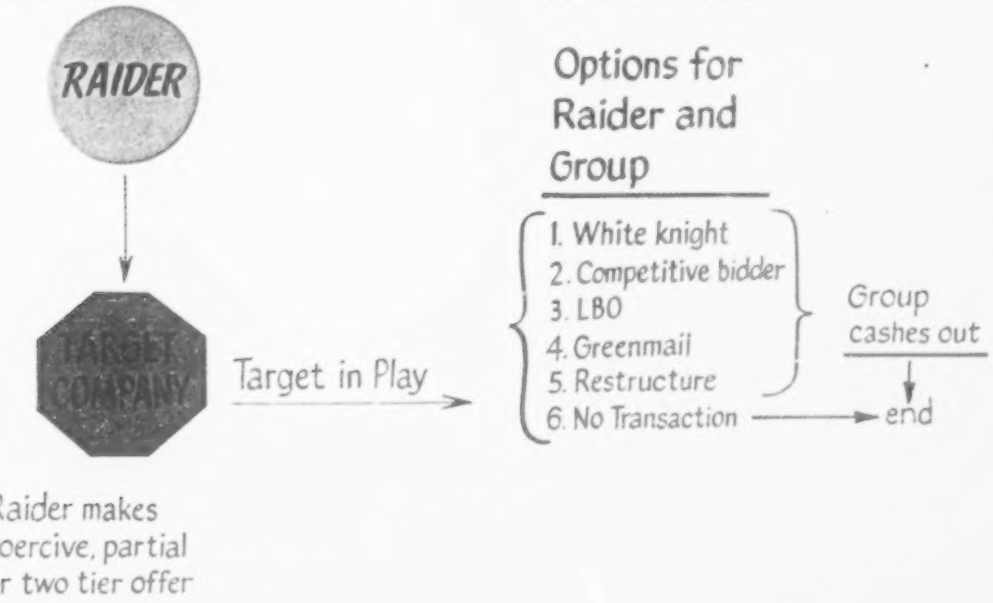
Group cashes out

End

ANATOMY OF A MANIPULATION

STEP 7

STEP 8



Target in Play

Raider makes coercive, partial or two tier offer

Options for Raider and Group

1. White knight
2. Competitive bidder
3. LBO
4. Greenmail
5. Restructure
6. No Transaction → end

Group cashes out → end

STATEMENT OF H.B. ATWATER, JR.
CHAIRMAN OF THE BUSINESS ROUNDTABLE TASK FORCE ON CORPORATE RESPONSIBILITY AND CHAIRMAN AND CHIEF EXECUTIVE OFFICER OF GENERAL MILLS, INC.
BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS ON WILLIAMS ACT REFORM

JUNE 25, 1987

Most discussions of this subject are either highly technical legal arguments or highly emotional appeals, or both. The emotional arguments are either that takeovers are necessary to throw out incompetent entrenched management and substitute the management of the raider; or, that fine, old corporations are being attacked and destroyed and should be protected from all hostile takeovers. These arguments create a great deal of heat, but very little light.

The basic problem is not hostile takeovers per se. Takeovers can be a useful part of the economic scene. Nor is the basic problem junk bonds, high corporate leverage, greenmail, the selling off of corporate assets, or wholesale employee terminations. These are all symptoms of the real problem.

The real problem is the abuse of our capital markets by a few manipulators who put companies into play for short-term financial gain, rather than long-term operating intentions.

Common sense tells us that something is fundamentally wrong when huge and unconscionable speculative profits can be made by the mere act of putting companies into play.

In this statement, we explore how companies get put into play. We also discuss who the players are, how they play the game, and the consequences of their activity. And finally, we offer comments and suggestions on Williams Act reform generally.

I. The Game That Must Be Stopped: Putting Companies Into Play.

A. The winners and how they win.

Although corporate raiders and arbitrageurs say a lot of different things about their intentions, their actions speak louder than words. Under existing rules, these people can and do make enormous profits with relatively little risk -- often simply by acquiring a block of stock of a target and putting the company "into play." Only in rare cases do they actually take over their targets. Much more frequently, the accumulation of a block of the target's stock and the initiation of takeover activity results in a run-up in the price of the target. This permits the takeover bidder to sell his block at a profit to the target in a greenmail transaction, to the target as part of a corporate restructuring undertaken in response to his accumulation, to a white knight brought in to acquire the target, or to a third party.

In 1985 the American Lawyer obtained a confidential 1980 memorandum from Carl Icahn to prospective investors setting forth, in a startlingly blunt fashion, his takeover plans. According to that memorandum:

> "It is our opinion that the elements of today's economic environment have combined in a unique way to create large profit-making opportunities with relatively little risk. . . It is our contention that sizable profits can be earned by taking large positions in 'under valued' stocks and then attempting to control the destinies of the companies in question by:

> a) trying to convince management to liquidate or sell the company to a 'white knight';
> b) waging a proxy contest or;
> c) making a tender offer; and/or
> d) selling back our position to the company."

True to his word to his investors, Icahn has made millions putting targets into play. According to press reports, he has taken option (d) or some variation thereof at least nine times. The following are profits (as reported by the press) from just some of his transactions:

- o $3 million for buying a 6% stake in Anchor Hocking and selling it back to the company in a greenmail transaction (doubling his money) one month later.
- o $7 million from American Can in greenmail when American Can bought 1,000,000 shares back from him at a 10% above-market premium.
- o $9 million for taking a position in Dan River and threatening a takeover, which led to a leveraged buyout initiated in response to his threats.
- o $13 million for acquiring a 10% stake in Uniroyal and selling it back to the company in a greenmail transaction, before Uniroyal went private in a leveraged buyout.
- o $10 million from Goodrich after acquiring just under 5% of that company and reselling it in a greenmail transaction at 25% above the then-market price.
- o $35 million for purchasing over 5% of Phillips Petroleum, threatening management with a two-tier tender offer and then disposing of his block after the sweetening by Phillips of a previously announced recapitalization plan.

Other takeover bidders have also had their motives questioned. The Wall Street Journal of March 20, 1987, discusses the track record of various raiders, all of whom have profited from selling out their stakes in takeover targets. For example, according to press reports:

- o Asher Edelman made approximately $30 million after acquiring just under 10% of Fruehauf Corp. and announcing a two-tier tender offer when another group took that company private in a defensive leveraged buyout. As frequently happens, Fruehauf also paid Edelman $21 million, in part for his investment bankers' and legal fees.
- o Irwin Jacobs and his associates made a profit of over $28 million after buying 7.7% of Walt Disney, threatening a proxy fight for control and then selling his block to the Bass family. In another, he and his associates made $31 million after acquiring over 11% of Avco, threatening a takeover and then selling his block to Textron and in the open market.

Other takeover bidders have similar records of "success." For example:

- The Haft family, through the Dart Group, has profited handsomely from "unsuccessful" takeover attempts for Beatrice Foods, May Department Stores and Jack Eckerd Drugs. In one case they made approximately $97 million after attempting a takeover of Safeway when they sold their block to Kohlberg Kravis Roberts in a leveraged buyout.
- Ronald Perelman earned over $40 million after acquiring more than 8% of CPC Corporation and apparently selling his block to CPC through CPC's investment banker, Salomon Brothers. And he made about $34 million in greenmail after acquiring approximately 14% of Gillette Company and then selling it back to Gillette.
- Sir James Goldsmith made $50.5 million for acquiring 8.6% of St. Regis Corp. and then reselling it in a greenmail transaction back to that company.

The track record of T. Boone Pickens, one of the most successful and well-known takeover bidders -- and a vigorous spokesman for keeping the takeover frenzy going -- is virtually identical. Pickens, like the others, almost never completes an acquisition after acquiring a block of target's stock and initiating takeover activity. In fact, in his recent book, Boone, he documents only two successful acquisitions by Mesa, his company. One, which occurred several years ago, was a negotiated deal which began as an unfriendly exchange offer. In the second one, his company acted as a white knight. In the past five years Pickens has not acquired a single company in a hostile takeover yet has cleared more than $1 billion in profits from these "unsuccessful" attempts.

In fact, Boone reveals that Pickens never intended, or even wanted, to gain control of many of his targets. For example, he admits that, "[w]ith Superior Oil, we were just an investor looking for a place to make a buck"; and "[w]ith Gulf [Oil], the prospect of acquiring the giant was unthinkable; we were just trying to get the management to do something for the shareholders, namely, get the price up." In the General American Oil (GAO) takeover, he admits that Mesa Petroleum Company's offer was a "no-brainer" because there was a "consulation prize" in the event that Mesa got outbid. Mesa owned 8% of GAO and had issued bonds that gave the holders the right to convert them into Mesa's block of GAO stock. However, unless the GAO stock price increased, Mesa would have to pay off the bonds. Thus, "[t]he only way to avoid a sure loss was to make an offer for GAO." In other words, Mesa's intent in making an offer was to push the GAO stock price up to avoid having to repay the bonds, not to take over the company. As one Delaware court put it, "Mesa has made tremendous profits from its takeover activities although in the past few years it has not been successful in acquiring any of the target companies on an unfriendly basis." The Delaware Supreme Court has noted Mesa's past history of greenmail, calling Mesa a "corporate raider with a national reputation as a 'greenmailer.'"

Pickens' record is replete with examples of takeover attempts in which Pickens never acquired his target, but rather sold out for a short-term profit -- often at the expense of the remaining shareholders. The following are estimated profits from some of his transactions:

- $32 million for announcing a hostile tender offer for Cities Service and selling back his block to that company.
- $45 million when Phillips Petroleum completed a white knight merger with General American Oil.
- Almost $32 million for selling back Mesa's stake in Superior Oil, ending months of takeover rumors.
- Pickens and his partners made $760 million with Mesa's share over $500 million by establishing a beachhead in Gulf Oil stock, announcing a partial tender offer and then watching Standard Oil of California complete a white knight merger with Gulf to form Chevron.
- $89 million after Phillips underwent a major, debt-laden restructuring and bought back Mesa's accumulated Phillips stock.
- In Pickens' Unocal fight, despite rumors that he lost money, Pickens ended by making $83 million (after taxes) by selling shares back to Unocal after withdrawing Mesa's hostile tender offer.

As the number of "unsuccessful" takeover raids continues to mount, the public is beginning to recognize what is really going on: takeover bidders believe that the profits lie in the takeover process, not in actually acquiring control of a target and trying to run it. According to a recent Harris poll commissioned by the Institute for the Study of Private Enterprise at the University of North Carolina, four out of five persons polled agreed that most hostile takeovers "are engineered by groups of big investors who are trying to drive up the price of the stock just to make a profit for themselves," and, by 72% to 19%, those polled agreed that hostile bidders "often are not interested in taking control over a company but instead are interested in greenmail, being paid a big profit from the management, as a price for their dropping their takeover bid."

Under existing rules, it is certain that tender offers and other takeover bids will continue to be made by persons whose primary motive is to share in the huge profits that can be made. There is simply too much easy money to be made for this not to be the case.

The Role Of Investment Bankers

In addition, there is growing reason to believe that investment bankers actively encourage takeover bids and seek to put companies "in play" -- even when they have no interested client -- in the hope that they might somehow be able to participate. As Felix Rohatyn of Lazard Freres testified before the Senate Banking Committee on January 28, 1987, "It is the age of the financial samurai."

A company is put into play when it is made to appear a likely takeover target, an appearance which usually becomes a self-fulfilling prophecy. An investment banker might initially identify a potential target, research it, put together a financing proposal and then approach a potential bidder and present the overall package in the hopes that the bidder will launch a takeover bid utilizing the investment banker's services, for which he will pay a very handsome fee, or that the target company will respond to the threat by retaining him to handle its defense.

Investment banking fees ranging from $5 million to $20 million and even higher are now common in corporate takeovers simply for financial advice and related services.[1] If the investment bankers place any of their own capital at risk, the fees are even higher. One might legitimately wonder what justifies the size of these fees. More importantly, one might also wonder what incentives these fees create for the investment banker. In fact, it is increasingly apparent that the fees create strong incentives for investment bankers actively to encourage takeover bids.

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[1] The attached Table details some of the investment banking fees that were earned in connection with large hostile or contested transactions over the past three years.

TABLE 1

LISTING OF SIGNIFICANT ACQUISITIONS AND FEES PAID TO INVESTMENT BANKERS IN SUCH ACQUISITIONS

1986[1]

TYPE OF TRANSACTION[2]	PARTIES	PRICE PAID OR BID	ACQUIROR'S BANKER AND FEE PAID	TARGET'S BANKER AND FEE PAID
TO	Burroughs acquires Sperry	$4.8 Billion	Lazard Freres $7.5 Million J. D. Wolfensohn $4.25 Million	First Boston $8.2 Million Salomon Brothers $8.0 Million Paine Webber $8.0 Million
LBO in response to TO	Investor Group acquires Safeway Stores	$4.2 Billion	Morgan Stanley $10.0 Million	Merrill Lynch $14.0 Million
TO	Campeau acquires	$3.6 Billion	First Boston $7.0 Million	Goldman, Sachs $13.0 Million
	Allied Stores		Paine Webber $5.75 Million	
TO	Unilever acquires	$3.09 Billion	Goldman, Sachs $8.0 Million	Shearson Lehman $11.0 Million
	Chesebrough-Pond's			
TO	Occidental Petroleum acquires Midcon	$3 Billion	First Boston $7.0 Million	Merrill Lynch $9.5 Million
TO	May Department Stores	$2.7 Billion	Morgan Stanley $6.9 Million	Shearson Lehman $6.0 Million
	acquires Associated Dry Goods			Goldman, Sachs $6.0 Million
LBO in response to TO	Forstmann Little	$2.1 Billion	Morgan Stanley $10.0 Million	Drexel Burnham $16.3 Million
	acquires Lear Siegler			Goldman, Sachs $4.0 Million
LBO & TO	Investor Group acquires	$1.5 Billion	Goldman, Sachs $[illegible] Million	Salomon Brothers $1.6 Million
	National Gypsum			Dillon Read $1.25 Million
LBO	KKR acquires Revco D.S.	$1.4 Billion	Salomon Brothers $6.0 Million Unterberg $8.0 Million	Goldman, Sachs $4.0 Million
TO	Lockheed acquires	$1.2 Billion	First Boston $4.0 Million	Kidder, Peabody $6.0 Million
	Sanders Associates			
TO & PF	IMC Holdings acquires	$1.2 Billion	Merrill Lynch $4.6 Million	Kidder, Peabody $6.2 Million
	Fruehauf			Salomon Brothers $1.25 Million
TO	Textron acquires Ex-Cell-O	$1.11 Billion	Bear, Stearns $4.5 Million	Goldman, Sachs $4.1 Million
TO	International Paper acquires Hammermill Paper	$1.1 Billion	Lazard Freres $4.0 Million	First Boston $3.84 Million Morgan Stanley $4.50 Million
TO	Quaker Oats acquires Anderson Clayton	$802 Million	Salomon Brothers $2.5 Million	First Boston $3.38 Million

1985[1]

TO	Baxter Travenol acquires American Hospital Supply	$3.7 [illegible]	First Boston $6.0 Million	Goldman Sachs $7.5 Million Merrill Lynch $5.0 Million
PP & LBO	SCI Holdings acquires Storer Communications	$2.25 [illegible]	Kohlberg Kravis $23.0 Million Kidder Peabody Not Available	Dillon Read $8.5 Million
TO	Pantry Pride acquires Revlon	$1.76 [illegible]	Drexel Burnham $[illegible] Million Morgan Stanley $[illegible] Million	Lazard Freres $[illegible] Million

1984[3]

TO & PP	SOCAL acquires Gulf Oil	$13.4 [illegible]	Morgan Stanley $[illegible] Million	Salomon Bros. $[illegible] Million Merrill Lynch $[illegible] Million
TO/LBO	Beatrice acquires Esmark	$2.[illegible] Billion	Lazard Freres $[illegible] Million	Salomon Bros. $[illegible] Million Wertheim $[illegible] Million
TO	Champion International acquires St. Regis	$[illegible] Billion	Goldman Sachs $[illegible] Million	Morgan Stanley $[illegible] Million
LBO	Investor Group acquires Malone & Hyde	$[illegible] Million	Shearson Lehman $[illegible] Million	Kidder Peabody $[illegible]
LBO & TO	Hanson Industries acquires U.S. Industries	$[illegible] Million	Shearson Lehman $[illegible] Million	Goldman Sachs $[illegible] Million
LBO	[illegible] Acquiring acquires Metro Media Communications	$[illegible] Million	Goldman Sachs $[illegible] Million	Salomon Bros. $[illegible] Million
TO	Waste Management acquires SCA Services	$[illegible] Million	Merrill Lynch $[illegible] Million	Kidder Peabody $[illegible] Million
TO	United States Gypsum acquires Masonite	$[illegible] Million	Salomon Bros. $[illegible] Million	Goldman Sachs $[illegible] Million
TO	[illegible] Ventures acquires Foster	$[illegible] Million	First Boston $[illegible] Million Morgan Grenfell $[illegible]	Morgan Stanley $[illegible] Million

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[1] Source: Corporate Control Alert, February, 1987, p. [illegible]

[2] TO - Tender Offer, LBO - Leveraged Buyout, PP - Proxy Fight

[3] Source: Fortune, January 20, 1986, pp. 27-29.

[4] Source: Corporate Control Alert, October 1986, p. 9.

The Investment Bankers Are No Longer Merely Advisers, They Are Key Players In The Takeover Game

With such huge fees at stake, it is no longer enough for an investment banking firm to wait for business to walk in the front door. "Instead of merely brokering transactions, [Michael] Milken [who heads Drexel Burnham Lambert's junk bond operation] and his associates are active participants. They will often identify targets and find smart, aggressive, individualistic entrepreneurs to go after the targets. These entrepreneurs made profitable deals, grow beyond their wildest dreams, pay fat fees to Drexel and fork over substantial interest payments to Drexel clients."[2] Similarly, "First Boston's 140-person M&A [merger and acquisition] department has its own 'creative director,' whose job is to think up deals the firm can suggest to its clients and new prospects."[3]

Because firms are increasingly dependent on these "deals" for revenues, "dealmakers in particular 'are under great pressure to keep finding new revenue sources to feed the monster that's been created,' says Samuel L. Hayes III, a professor of investment banking at the Harvard Business School. 'There 's been steady movement away from the traditional role as counselor toward activity initiated by the investment banker himself.'"[4]

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[2] "A One-Man Revolution," Forbes, Aug. 25, 1986, p. 34.

[3] "American Business Has a New Kingpin: The Investment Banker," Bus. Wk., Nov. 24, 1986, p. 80.

[4] Id.

The Wall Street Journal reports that because of the huge profit potential of acquisitions, "nearly every major investment-banking firm is trying to trigger takeovers -- and often generating controversy over tactics."[5] Consider these examples:

In August 1985, Beatrice Cos.'s stock price rose sharply amid takeover rumors. One Beatrice executive alleged that Bruce Wasserstein, co-head of First Boston's Merger Department, told him and another executive he had put Beatrice into play, but that it was not "too late." They interpreted his remarks to mean that he would find a raider to launch a bid if Beatrice did not retain him as an advisor. Wasserstein claimed later that his statement was not a threat, just a prediction that Beatrice would be taken over. Ultimately, Beatrice was acquired by Kohlberg, Kravis, Roberts & Co. in a leveraged buyout, after extensive takeover speculation, purchases of Beatrice stock by arbitrageurs and increased stock prices and trading volumes.[6]

In yet another transaction involving Wasserstein, a lawyer for Unilever N.V. alleged that Wasserstein told Unilever that American Cyanamid was considering a bid for Richardson-Vicks, Inc., a potential Unilever target. Unilever thereupon launched its own unsuccessful bid for Richardson-Vicks, which was eventually acquired by a white-knight, Procter & Gamble. The Unilever lawyer claims that he later learned that

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[5] "The Deal Makers," Wall St. J., April 2, 1986, p. 1

[6] Id.

American Cyanamid never planned a bid for Richardson-Vicks. Wasserstein claims that he simply passed on rumors.[7]

Drexel Burnham Lambert also has been accused of actively putting companies into play. According to Business Week, "[c]orporations have long complained privately about Drexel's hardball tactics in securing new clients and retaining old ones. Fearful of retaliation by Drexel, however, they have almost never been willing to go public with their concerns."[8] Recently, however, two companies have been willing to do so. In 1985, Green Tree Acceptance, Inc. retained Drexel to sell about $320 million of stocks and bonds for Green Tree in a public offering. Green Tree contends that it asked Drexel for a broad distribution of its shares and received assurances that Drexel would not allow one of their clients to take over another one of their clients. However, Drexel placed a 9.9% block of Green Tree's shares with corporate raider Saul Steinberg, a longtime Drexel client. Green Tree alleges that Drexel did so despite repeated expressions of concern on Green Tree's part that the distribution not leave Green Tree vulnerable to a takeover attempt. Steinberg began buying additional shares and eventually was bought out by Green Tree in a settlement. Green Tree has filed suit against Drexel over the transaction.[9]

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[7] Id.

[8] "Did Drexel Bully Takeover Candidates?" Bus. Wk., Mar. 9, 1987, p. 43.

Similarly, Staley Continental, Inc., has alleged, in a lawsuit against Drexel, that Drexel attempted to force Staley to use Drexel as an investment banker so that Staley could be taken over by a leveraged buyout group sponsored by Drexel and Staley management.[10] According to Staley's complaint, Drexel and its associates began making substantial open-market purchases of Staley's stock in late October 1986, causing the trading volume to rise substantially above historic levels. Thereafter, Drexel allegedly contacted Staley's management several times to discuss Drexel's interest in establishing an investment banking relationship with Staley, informing Staley that Drexel had acquired a "large position" and allegedly suggesting the possibility of a leveraged buyout by Staley management. James Dahl, a Drexel executive who had been involved in the Green Tree transaction, purportedly told Staley that "it is very important for us to sit down and talk before you do something that hurts me and before I do something that hurts you." Staley had planned to make a public offering of a new common stock issue, but Dahl allegedly made it clear that Staley should not use an investment

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[9] See "Inside Milken's Empire," Wash. Post, March 8, 1987, pp. H1, 1-4; "The Deal Makers," supra, at p. 16.

[10] "Did Drexel Bully Takeover Candidates?" supra; Coll and Vise, "Suit Charges Drexel Executive Threatened Staley Continental," Wash. Post, Mar. 8, 1987, p. H8.

banker other than Drexel and suggested that if offering went forward, management would be "thrown out." Staley went forward with its offering nonetheless and alleges that Drexel responded by dumping large blocks of Staley stock, causing its price to decline quickly and forcing Staley to withdraw the offering. Staley has alleged numerous securities law violations by Drexel and otherwise in connection with this series of events, allegations which Drexel has strongly denied. At this time, the lawsuit remains pending.

Along with the raiders and arbitrageurs, the investment bankers have played a major role in promoting the rapid increase in takeover activity that has occurred in recent years. Peter Drucker, a respected business professor, has described the current wave of hostile takeovers as "inverted raids by Wall Street firms who decided they could organize looting expeditions against vulnerable companies."[11] All too many of these takeovers are based not on sound economic factors, but on a desire for quick profits through a bust-up liquidation of the target or greenmail and investment banking fees. What is needed is legislation which would either prevent the manipulation of companies into play or eliminate the profitability of such activity, while allowing economically sound acquisitions to go forward.

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[11] Schrage, "We Haven't Seen the Last Of This One," Wash. Post, Feb. 17, 1987, p. D1.

B. How The Game Is Played: A Typical Scenario

For the most part, merger and acquisition activity in the United States is appropriate, economically healthy and conducted in a straightforward, above-board fashion.

Regrettably, a small number of people are engaged in a very different sort of game. This game is orchestrated by a coordinator, usually an investment banker, who is in constant touch with other players (corporate raiders, arbitrageurs, asset managers) with large sums of money to invest for short-term profit.

The coordinator's first task is to get several investors to take significant positions in the stock of a healthy company (typically with undervalued assets). He then surreptitiously circulates rumors in order to create the impression that the company is the subject of a takeover attempt.

In some instances, the coordinator conceives and promotes the game plan. In others, a raider or arbitrageur may sense the opportunity, take an initial position, and use the coordinator to involve others in his stratagem. Group members are careful in this initial stage to keep their individual stock positions to less than 5% in order to avoid detection by reason of a 13(d) filing with the SEC, and to avoid dealing directly with one another so as to evade the reach of existing law on disclosure and insider trading.

In the typical scenario, the members of the group being coordinated together own approximately 20% of a company's stock -- a sufficient amount in most publicly traded corporations to

assure effective control of the company to anyone buying that block of stock.

If rumor and innuendo are not sufficient, the coordinator arranges for some of the participants to trade large blocks of stock back and forth among each other, with the coordinator's brokerage division crossing the trades. The net position of those engaged in this cross-trading doesn't change, but it appears to others not privy to this private arrangement that there is a lot of activity in that stock.

At this point, the coordinator will arrange for an institutional asset manager or a friendly stock analyst, quite possibly one who works on the other side of his firm's so-called Chinese Wall, to comment or publish a report giving a very high figure for the break-up value of the company. This is the amount each share would be worth if the company were dismembered, piece by piece, and sold off -- an arm to this buyer, a leg somewhere else, and so on.

The combination of rumored takeover activity and a high break-up value is designed to pull others into the action even though the price has moved up and to suggest to a potential acquiror that he can afford to pay at inflated prices and still make a bargain purchase of the assets and/or a substantial profit on the deal.

It's usually at this point that the coordinator goes calling on legitimate potential purchasers of the target company He tells them that the target company is in play and that it is ripe for picking. The potential acquiror is told that both the opportunity and the moment for action is now, or it will be irretrievably lost. The coordinator also lets it drop that he is confident he can assemble a large block of the target company's stock, say 20%, in a very short time.

Sometimes this works, sometimes it doesn't. If it does, the coordinator arranges for the sale of the block controlled by the members of his group at a substantial premium over the price they paid for it and pockets the commission. He also tries to become the investment advisor and financier of the acquiror's efforts to purchase the rest of the company. Or he will approach the target company and offer to handle its defense.

If the coordinator can't find a legitimate buyer, his next ploy is to approach the company and try to get it to pay greenmail. He tells the company that it is in play, or nearly so, and in a very precarious position. He indicates that there are several holders of large blocks, that he knows who they are, and that the company would be well advised to remove this volatile block of stock from the market by buying the shares itself. He also tells the company that the investors simply want to get out of their positions at a profit, and if the company doesn't assist them in meeting this objective they will have to find someone with hostile intentions to do so.

Unlike the more widely known instances of greenmail, these greenmail payments are seldom publicized and occur well before any public announcement of a tender offer or intention of seeking control.

If this fails, the coordinator tries to find someone, usually a member of his group, to announce his intent to make a tender offer for a certain percentage of the target company's stock, subject to financing and other conditions which leave the offeror a multitude of escape routes. In fact, as stated earlier, the offer is almost never a genuine effort to gain control of a company and run it. Rather it is a ploy to attract further attention to the target's weakened condition and to pose a sufficiently real threat that a large enough block of stock will wind up in hostile hands, that the target company's independence is seen to be at risk.

Sometimes this tender offer will be a variation of a partial tender known as a two-tier tender. In this move, the offeror makes a cash offer for a certain percentage of the stock and announces simultaneously that he will redeem the shares not tendered in his original offer by issuing stock in a newly merged company or for debt securities, neither of which will be as attractive or as certain as cash. The offeror (and his target) calculates that this will scare investors into tendering their shares into his initial offer for fear of being stuck with low-grade paper if they hang on and he gains effective control of the company.

The coordinator and the raider both hope that these moves will be sufficiently strong to force the company to pay greenmail, draw in a competing bidder who will take them out of their position at a nice profit, cause the company to seek a friendly purchaser, known as a white knight, who will do the same thing, or cause a self tender by the company. In any of these scenarios, the raider and the coordinator profit handsomely.

It is interesting to note that the partial or two-tier tender is the typical tactic of the most widely known corporate raiders, who seldom, if ever, actually buy a company and try to run it.

While these manipulative activities are terrific for a few speculators, they have real and damaging consequences for the target company, its employees, the communities in which it operates, its major customers and suppliers and the ability of our economic system to focus on producing competitively. They also victimize other shareholders by concealing important information and coercing them into doing what the manipulator wants or be left in a very vulnerable position.

C. The Consequences of a Flawed Takeover Process

When companies are put in play so that a handful of people can make very large short-swing profits, nothing of economic value is created. Value comes when one operates a company, invests in R&D and new plant and equipment, creates new products and develops markets for them. In this kind of process, new wealth is generated and everyone can share in the gains.

By contrast, the quick-buck manipulation of companies into play which results in huge profits for the few is purely a financial transaction which adds no new wealth. It is a zero-sum game in which the winners win at the expense of the losers. When equity is extracted from companies to pay for the profits made by the small group raiders and arbs, it must be financed. It is in the financing of those profits that one can observe the adverse consequences of this game.

One obvious set of losers are the shareholders who sold their shares to the arbs and raiders who were amassing positions in anticipation of the company being put into play before other investors in the marketplace knew about it. As Nicholas Brady, Chief Executive Officer of Dillon Read and a former U.S. Senator, said in testimony before the Senate Banking Committee, "There is something unfair when a bidder acquires economic control... without paying a control premium and without offering all holders the ability to sell at the same price." Flaws in the current rules governing disclosure and the tender offer process permit the kinds of manipulations and abuses which create this unfair result.

Another group that loses in the current process are the bondholders of the target company. Because the acquired company is frequently leveraged up or restructured in order to finance the equity being extracted in profits by the raider and his friends, the resulting balance sheet is substantially weakened, thus affecting the investment quality of debt securities previously issued by the company. In effect, those investors suffer an immediate downgrading of their previous investment without any notice or effective recourse.

Many have commented with alarm over the rapid rate at which equity is being replaced by debt in American corporations. In each of the past two years, over $75 billion in equity has been withdrawn from the system, a phenomenon which has drawn expressions of grave concern from retiring Federal Reserve Board Chairman Volcker as well as Chairman Shad of the SEC. Debt that is issued not to create investment and growth but simply to pay for the profits of financial transactions which do not add any economic value or growth is, indeed, very worrisome.

Nor can one take comfort in the business combinations that frequently result from putting companies into play, when third-party acquirors move in to pick up the pieces left behind by the "unsuccessful" raider. As Felix Rohatyn notes in his appearance before the Senate Banking Committee, "A large part of the oil industry has been reorganized as a result [of raids]. The mergers of Chevron-Gulf, Occidental-Cities Service, Mobil-Superior all occurred as a result of raids or the threat of raids. The deterioration in their combined balance sheets has been dramatic. Far from being a healthy restructuring, the oil companies involved are cutting exploration sharply, a practice our country will pay for dearly when the next energy crisis occurs.... If one were to write a scenario about how to get the U.S. into trouble as far as energy is concerned, it would be hard to improve on what has happened."

Rohatyn went on to explain some of the other financial consequences of the current game. "If the takeover is successful, the servicing of very high levels of debt, at rates of interest in excess of most target's return-on-investment, requires significant asset dispositions which may not always be possible or desirable. It is an approach that also completely fails to take into account the fact that a large corporation is an entity with responsibilities to employees, customers and communities, which cannot always be torn apart like an erector

set. The alternative to a breakup requires significant improved cash flow performance. This requires cutbacks in R&D, capital spending, and usually, significant reductions in employment. It may cause some companies to be leaner and more competitive; it may also require sacrificing the future."

Effect on Employees

Peter Drucker, the respected business professor and commentator, observes that "employees, from senior middle managers down to the rank and file in the office or factory floor, are increasingly being demoralized -- a thoughtful union leader of [his] acquaintance calls it 'traumatized' -- by the fear of a takeover raid."[12] As others have noted, when a takeover bid is made,"[m]any key employees -- well aware of acquisitors' penchant these days for wholesale layoffs and salary and benefit cuts -- quit rather than wait out an uncertain future or are so distracted from their work that the company suffers."[13]

Employee fears of takeover-induced restructurings and resulting losses of jobs or benefits are, if anything, increasing. For example, Holiday Corp., the parent company of the Holiday Inns hotel chain, recently announced a massive operational and financial restructuring, apparently motivated in part by concerns that Holiday was a likely takeover target. Because of employee concerns about the restructuring, which they saw as "extraordinarily risky," a union representing Holiday employees in Las Vegas asked the Nevada Gaming Control Board to require that Holiday post a $50 to $100 million bond to protect the wages and benefits of Holiday's approximately 6,000 Nevada workers.

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[12] Drucker, "Taming the Corporate Takeover," *Wall St. J.*, Oct. 30, 1984, p. 30.

[13] "Here Comes the 'Tin' Parachute," *Dunn's Bus. Month*, Jan. 1987, p. 62.

The employees' fear of hostile takeovers is not at all surprising when one considers the high probability that jobs or benefits will be lost in the aftermath of a raid. In testimony before the Subcommittee on Employment and Housing of the House Government Operations Subcommittee on March 31, 1987, Dr. Richard S. Belous, a labor economist with the Conference Board, estimated that as many as 500,000 managers have lost their jobs as a result of mergers, acquisitions and restructurings and said that his research has found a direct statistical correlation between the extent of acquisition activity and loss of jobs and reduced wages.

Overall, according to The Wall Street Journal estimates, between January 1984 and mid-July of 1985 alone, at least 98 operational restructurings of companies resulted from or followed acquisitions, which affected approximately 550,000 employees.[14]

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[14] "Shifting Strategies," Wall St. J., Aug. 12, 1985, p. 1.

Some of the more significant acquisitions in recent years have resulted in substantial job losses. For example, when Sperry Corp. succumbed to a hostile bid by Burroughs Corp., some 9,600 jobs reportedly were to be eliminated. When Safeway was subjected to a hostile bid by the Haft family and was then acquired by an investor group in a leveraged buyout, an estimated 7,500 jobs were lost. After a hostile bid was made for Midcon Corp., it was acquired by Occidental Petroleum and 2,000 jobs were phased out, with another 1,000 expected to follow. After Baxter Travenol Laboratories Inc.'s acquisition of American Hospital Supply Corp., 6,500 jobs were expected to be eliminated over a four-year period. Finally, when Socal acquired Gulf Oil, after Gulf had been put into play by a hostile partial tender offer by a group headed by T. Boone Pickens, Socal promptly offered early retirement to 11,000 employees, laid off or transferred 3,830 employees and the jobs of 15,000 service station operators were threatened. By June 1986, Chevron Corp., the company resulting from the merger, had cut its combined workforce from about 79,000 immediately following the merger to 57,000 employees.

Even if the company remains independent, employees still fear a bid and its aftermath because they know that the company is likely to be so weakened that jobs again will be threatened. For example, Carl Icahn's unsuccessful raid on Dan River, a textile manufacturer in Danville, Virginia, left the firm burdened with debt. Dan River had to eliminate 2,000 local jobs -- while Icahn earned an estimated $8.5 million profit on his $14 million investment. Similarly, after Boone Pickens' and Icahn's successful raids on Phillips Petroleum, Phillips' workforce declined from 29,300 to 22,000 employees, a third of which, a Phillips' executive claimed, were directly attributable to Icahn's raid.[15]

II. How Filling Current Gaps In The Williams Act Could Slow Down The Game

A. Disclosure of stock accumulations

Secret stock accumulations are a key element of most takeover bidders' strategies. By acquiring a significant block of a target's stock without disclosing his activities, a bidder can virtually assure himself of profit when the stock price increases after the accumulation is announced. Unfortunately, the profit made by the bidder comes at the expense of unwitting shareholders who sold to him during the secret accumulation program.

When a takeover bidder establishes his "beachhead" in the target before reporting to the SEC, he deprives selling shareholders of the crucial information that he is planning a takeover bid, which would put the target "in play" and likely result in a runup of its stock price. The record is full of examples of how far bidders will go to keep their buying programs secret. One such case is Mesa's secret acquisition program for

shares of Gulf, which Boone Pickens described as follows:

> "It was important to keep our buying a secret, in part to maintain the advantage that comes with surprise, in part to avoid a run-up in the price.... We devised an elaborate security system. Only a handful of people at Mesa were privy to our buying, and only two knew the details of the transactions. We drew down our entire line of credit in advance, so that our banks would not detect a pattern of borrowing and buying. We established numbered bank accounts with restricted transfer procedures. Only one person at each bank knew that the accounts belonged to Mesa, and only Sydney Tassin knew all the account numbers and transfer authorizations. When it was time to pay, we would transfer cash from a Mesa account to one of the numbered accounts, then transfer it again to another numbered account at a different bank. The money was then transferred to Bear, Stearns & Company to pay for the stock."

The obvious effect of this secrecy is that, during the buying program, the target's shareholders do not seek or obtain a control premium in their selling price. When the bidder's holdings and intentions finally are announced, and the stock price climbs, shareholders who already sold to the bidder are left out.

To correct this unfairness, we recommend: disclosure on a more timely basis; lowering the threshold that triggers the reporting obligation; adopting measures designed to deter false reporting and evasion of reporting by groups and requiring more complete reporting by certain persons and entities, including institutional investors, who evade, or who are not currently subject to, full disclosure obligations. Each of these recommendations is discussed in turn.

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[15] "Carl Icahn: Raider or Manager?," Bus. Wk., Oct. 27, 1986, pp. 98, 104.

1. The delay in reporting holdings should be reduced. Under existing law, a takeover bidder may delay reporting his accumulation under Section 13(d) of the Securities Exchange Act until 10 days after his holdings pass 5%. This 10-day period, referred to as the "10-day window," provides ample opportunity for substantial profit by the bidder at the expense of the selling shareholders who, as discussed above, sell to the bidder without knowledge of the acquisition program and who as a result do not obtain a control premium. The 1983 Report of the SEC's Advisory Committee on Tender Offers stated: "The 10-day window ... present[s] a substantial opportunity for abuse, as the acquirer 'dashes' to buy as many shares as possible between the time it crosses the 5% threshold and the required filing date."

Some recent examples of abuse of the 10-day window include AFG Partners' offer for Lear Siegler in November 1986, in which it simultaneously announced that it had already acquired nearly 10% of Lear Siegler. No Section 13(d) filing had been made previously, even though AFG admitted that it had been buying stock since September. In early October of 1986 Lear Siegler's stock was trading in the mid-$50 range. By the time AFG announced its $85-a-share bid, the stock had risen to about $80 per share, fueled by rumors someone was acquiring a block. As a result, shareholders who sold in October gave up approximately $25 per share because of ignorance about AFG's intentions.

Sir James Goldsmith acquired an 11.5% block of Goodyear stock before announcing his holdings and intention to launch a tender offer bid. Goldsmith paid an average of $42.20 for each

of those shares, proposed to offer $49 per share in his takeover bid, and eventually sold his stock back to Goodyear for $49.50 per share. His approximately $93 million profit, like that made by AFG, came at the expense of innocent Goodyear shareholders who sold to him prior to the disclosure, and was made possible in significant part by the 10-day window. In his takeover of Crown Zellerbach, Goldsmith acquired an 8.6% block of Crown Zellerbach before reporting (though he had announced several months earlier he might acquire as much as 25% of the company's stock). Goldsmith paid $32 to $35 per share before reporting his holdings. After his report was filed, the stock price rose steadily into the low-$40 range.

Carl Icahn likewise acquired a 9.8% block of USX and 20.5% of TWA before reporting. In his USX bid Icahn paid an average of only $21.50 per share for his beachhead stake, but his initial tender offer was $31 per share. Millions were lost by shareholders who sold before the Section 13(d) filing.

2. The amount of stock that triggers the reporting obligation should be lowered. Even if the delay in reporting is shortened, bidders would nevertheless continue to reap profits at the expense of unwitting shareholders. By permitting acquisitions of up to 5% without any reporting, AFG, Icahn and Goldsmith still would have profited from the Lear Siegler, Goodyear, Crown Zellerbach, TWA and USX shareholders who sold before a Schedule 13D was filed. The amount of stock necessary to trigger a filing obligation thus should be reduced to 2.3% so as to deter raiders from profiting by their secrecy at the

expense of the shareholders and from concealing parallel purchasing by collaborators..

3. False reporting of intentions should be more effectively discouraged. Takeover bidders often continue making purchases after reporting under Section 13(d) that they are purchasing merely "for investment." More often than not, such statements fail to disclose the bidders' real desire to seek control or put the company into play. As with failures to file, while such statements are unlawful if they were knowingly false at the time they were made, proving that is exceptionally difficult and, even so, they rarely result in any significant penalties.

For example, when Pickens originally filed a Schedule 13D to report his Unocal holdings, he claimed they were "solely for investment." When Pickens launched a takeover bid for Unocal, Unocal sued to enjoin the offer, alleging that Pickens' initial filings falsely represented his intentions. A California federal court agreed, concluding that Pickens' Mesa Partners II "from the outset intended to put Unocal 'in play' and thereby either obtain control or 'greenmail' the corporation in exchange for dropping its bid." As is frequently the case, however, the court's remedy was only to require coercive disclosures and a three-week extension of the tender offer withdrawal period. Equally disappointing was the SEC's remedy for its charges that Mesa had violated Section 13(d) by failing accurately to report its intentions for Gulf; Mesa was able to consent (without admitting guilt) to an injunction that restrained it from future violations.

4. Evasion of reporting requirements by groups should be eliminated. Takeover bidders also act collectively to evade the reporting requirements until they have accumulated enough stock. If each person's holdings in a target remain below 5%, by not admitting that they are acting together as a "group," takeover bidders and arbitrageurs can significantly increase the amount of stock they control and continue to buy in secret from unsuspecting shareholders without reporting under Section 13(d). Unfortunately, without disclosure of agreements and contacts between members of such a group, it is extremely difficult to detect and prove that the group is operating when it engages in secret collusion.

Allegations of collusion among bidders, arbitrageurs, investment bankers, institutional investors and other market professionals are now coming to light in significant numbers. For example, there have been reports in several publications that Carl Icahn and Ivan Boesky jointly attempted to put Gulf & Western Industries into play in 1985. Although their aggregate holdings exceeded the 5% threshold, they were not reported to the SEC or the issuer. Eventually Gulf & Western reportedly was forced to buy back their stock in order to end takeover rumors. These same reports also suggest that Icahn and Boesky worked together throughout Icahn's bid for Phillips Petroleum in 1985.

Furthermore, in two cases this year, the Government has brought charges alleging illegal arrangements to "park" stock with one another to conceal the stock's true ownership. In late January, Michael Davidoff, Boesky's chief trader, pleaded guilty to criminal charges that he had parked stock through bogus trades with Seligmann, Harris & Company, a London broker. The purpose of the trades, according to the charges, was to evade federal laws designed to protect investors by requiring brokers to maintain minimum amounts of capital. Additionally, according to the recent SEC complaint against Boyd Jefferies, Jefferies parked securities on behalf of Boesky's Seemala Corporation and Seemala parked securities at Jefferies, which, among other things, permitted Seemala to circumvent its Section 13(d) reporting obligations. Shares parked included securities in Pioneer and Phillips Petroleum, both of which were takeover targets.

5. *Reporting requirements for institutional investors and similar entities should be expanded*. It also appears that institutional investors, such as money managers, pension plans and similar persons and entities may be taking advantage of certain of the reporting requirements of the Securities Exchange Act to become involved in the takeover process without reporting their activities.

Under existing law, an institutional investor who holds more than 5% of a company's stock may be eligible to report on Schedule 13G (rather than Schedule 13D) if the investor is not holding the stock for the purpose of changing or influencing control of the company. The Schedule 13G need only be filed 45 days after the end of the calendar year in which the 5% threshold is crossed and be updated annually. The Schedule 13G essentially is a short-form Schedule 13D; in particular, no detailed information concerning the investor's purpose in holding the stock is required.

Yet there is now evidence that institutional investors have become involved in takeover activity. For example, it has been reported that Forstmann-Leff Associates, a pension fund manager, accumulated a block of stock of Hammermill Paper that at one time exceeded 16% of Hammermill's outstanding stock, which it reported on Schedule 13G, as a passive investor; Forstmann-Leff later filed a Schedule 13D to be covered if activities leading to a transaction should occur. Among other things, it has been alleged that Forstmann-Leff contacted several potential takeover bidders for Hammermill and ultimately sold some of its stock to Paul Bilzerian, who immediately thereafter launched a takeover bid for Hammermill.

Moreover, under Section 13(f), institutional investors who manage $100 million or more in certain securities need only report their holdings 45 days after the end of each calendar quarter (unless they trigger the Schedule G or Schedule D filing requirements). Thus, the activity by such investors in stocks of takeover targets, if reported at all, is reported long after it would be of use to investors. To make matters worse, institutional investors reporting under Section 13(f) may seek and obtain from the SEC confidential treatment of their filings. For example, Drexel Burnham Lambert has routinely sought and obtained confidential treatment for its filings under Section 13(f). Such treatment obviously makes it impossible for the investing public to learn of takeover-related activities by active players of the takeover game (such as Drexel Burnham) until it is too late.

Therefore, as institutional investors become more involved in the takeover process, increased disclosure, and more timely disclosure, by such investors of their activities is essential to fairness and equal treatment of all shareholders.

B. Eliminate Manipulative, Coercive Or Phony Tender Offers.

There is little doubt that partial and two-tier tenders as used by corporate raiders are coercive, deprive shareholders of a fair chance to receive a full control premium for all their shares, and are often used to manipulate companies into play.

In two-tier offers, the raider offers cash to acquire generally less than all of the shares of a target, but still a sufficient number to give the raider control. Such control can be anywhere from 20% to over 50% of the target's stock. In his tender offer documents, the raider states that, once he has acquired control, he will cause the target company to enter into a merger in which its remaining shareholders will receive an amount less than, or in a less desirable form than, the price offered in the tender offer.

When faced with the first-tier, cash portion, of a two-tier offer, a target shareholder is faced with a dilemma: Whether or not the shareholder is satisfied with the price being offered in the first tier, he would risk getting an even lower price if he does not tender and the raider acquires control and forces a second-stage merger. Because the first tier offer is usually at a substantial premium above the market price, most

stockholders are not willing to take the chance that enough other stockholders would refuse to tender so that the tender offer would be defeated. This is particularly true in companies whose shares are held by pension fund asset managers, whose fiduciary duties place them in an extremely vulnerable legal position if they fail to tender in such a situation. The result is that enough shares usually are tendered to make the tender offer successful, whether or not the overall consideration being paid for the company fairly reflects its value.

Partial offers can have the same effect as two-tier offers. Indeed, in some ways partial tender offers are even more coercive because the shareholder does not know, when making a decision whether or not to tender, what he will obtain in the future for those of his shares that are not purchased in the tender offer. One thing he does know is that the target's stock is likely to decline after a raider acquires control in a partial tender offer; once the raider has control, he is not likely to offer a control premium to purchase further shares.

Partial offers also permit the raider to acquire effective control by paying a control premium for less than all of the shares. And, while a partial tender offeror may not disclose his plans for the remaining shareholders, he could always force onto the remaining shareholders a second-stage transaction, at an unfairly low price. One such example is Mesa's raid on General Amerian Oil, in which Mesa sought more than 50% of General American's shares, which, according to Mesa documents, would enable Mesa to "replace all of the [General

American] board" and force the remaining shareholders to accept "debt or equity securities of Mesa, or a combination thereof, on such terms and in such amounts as Mesa may determine."

For these reasons, two-tier and partial tender offers permit raiders to gain control at the expense of the remaining shareholders. This is particularly the case when the raider uses debt securities in the second stage that are secured by the target's assets in order to finance the raider's acquisition costs. As Martin Lipton has noted, two-tier and partial tender offers are "devices through which unsophisticated shareholders are taken advantage of by professional investors. . . . They are devices by which a target's own balance sheet is used to finance a raid."

Even Boone Pickens, the leading spokesman for corporate raiders, believes that two-tier offers can be coercive. When Cities Service made an offer of $21 for half of the stock of Pickens' Mesa Petroleum Company and announced that the remaining half would be exchanged for Cities' securities, Pickens labeled the offer "as coercive as you can get" and "unfair to Mesa's stockholders."

Yet Pickens, like the other raiders, has utilized two-tier offers. When Mesa went after Unocal, it offered $54 per share cash for a majority of Unocal's shares, with the remaining shares to be purchased with debt securities which Mesa claimed were worth $54 per share. However, the value of the debt securities was at best uncertain and clearly less valuable to Unocal's shareholders than cash. The Delaware courts agreed, terming Mesa's offer a "grossly inadequate and coercive two-tier, front-end loaded tender offer."

Pickens' frequent use of the partial offer as a tactic demonstrates another reason why it is subject to abuse. The partial offer is sometimes used as a means of putting a company in play, not in order to acquire the company, but in order to profit from resulting transactions such as competing bids or corporate restructurings. In the last five years, Pickens' companies have made offers for an amount of stock sufficient to raise his group's stake in Gulf Oil from 13% to 21%; for an amount of Phillips Petroleum stock necessary to raise Mesa' stake to as much as 20% of Phillips; and for an amount of Unocal stock necessary to raise Mesa's stake to just over 50% of Unocal. Had Pickens succeeded in acquiring control of any of these companies, he would have avoided paying a fair share of the control premium to all shareholders. More importantly, not one of these targets was actually acquired by Pickens; in all cases he sold out at a handsome profit. Indeed, in the case of Gulf Oil, Pickens even admitted that his partial tender offer was made only in an effort to earn a quick profit.

Other recent examples of coercive two-tier tender offers include:

- o Saul Steinberg's two-tier offer for John Blair, with the first tier a cash tender offer at $31 per share for 61% of John Blair's shares, and the second tier an exchange of stock and junior subordinated discount debentures for the remaining shares. The cash offer was over-subscribed by shareholders, who obviously preferred that offer to the paper consideration being paid in the back end;

- NV Homes' offer for Ryan Homes for $48 in cash for 45% of Ryan, with the remaining shares to be exchanged for cash and securities with a total asserted face value of $48 per share;
- Allied Corp. and Ultramar PLC's combined acquisition of Enstar Corp., in which they paid $20 per share in cash for 50.4% of Enstar's stock and a combination of $2 per share in cash and participation certificates in an Indonesian natural gas drilling joing venture for the remaining stock; and
- Allegheny International's acquisition of Sunbeam Corp., in which it purchased 49.6% of Sunbeam's shares through a $41 per share cash tender offer, and then initiated a back-end merger in which it exchanged shares of a new issue of its convertible preferred stock with a nominal market value of approximately $32 for each remaining Sunbeam share.

These examples only serve to reinforce the belief that two-tier and partial tender offers are frequently coercive and unfair tactics which act to the detriment of shareholders.

We recommend that the Committee put an end to these abusive tactics by requiring that any acquisition of a company's shares beyond a 15% threshold be made by a tender offer for any and all of the outstanding shares. This would at once deal decisively with partial and two-tier tenders, and would also take care of phony tenders and sweeping the street.

Another approach to the abuse of putting companies into play for short-term profits would be to require a bidder to disgorge any profits realized on the sale of shares held less than 6 months prior to his initiation of a bid for control unless he holds those shares for at least 6 months after withdrawing his bid. This would take the economic benefit out of an offer which is not a sincere effort to gain control but rather a ploy to drive up the stock price for a short-term play.

In practice, this would be quite analogous to the treatment of corporate "insiders" under Section 16(b) who must disgorge any profits realized from buying and selling (or vice versa) shares in their company within a 6-month period. Whether or not these individuals have actual inside knowledge is moot; the mere fact that their positions make that possible creates a presumption of "insider" status. In like manner, an individual making a tender offer for a company would be deemed to have inside information by reason of that status.

C. Provide Adequate Time For Consideration Of Offers

In addition, we commend the Committee for extending the minimum tender offer period to 35 business days. Disclosure without adequate time for the market to absorb that information is of little benefit. The Committee also recognizes that the current process results in a mad scramble in which major decisions are taken hastily, and there is almost no time to develop alternatives that may be either more economically attractive to shareholders or, equally important, provide them and other important constituencies with greater long-term value. Where so much is at stake for so many people there is every reason to create a process which allows for exploration of important facts and alternatives and permits decisions to be taken with calm deliberation.

III. Other Considerations in Approaching Williams Act Reform

A. Most Corporate "Defenses" Are Appropriate Reactions To Current Abuses

Contrary to the propaganda of those who don't want hampered their right to buy companies and tear them into bits without concern for their long-range prospects, the competence of management, the concerns of employees, communities, suppliers, customers, most managements do not resist unnegotiated takeovers to entrench themselves. They do it because -- and rightly so -- they don't want to see the values inherent in their company, the long-term gains that will accrue from the continuation of it as an independent entity, and the interests of the company's many constituencies wantonly destroyed by an invader concerned only with immediate enrichment. Any management with faith in itself, a long-range plan it believes will benefit the company and its constituents, a commitment to continuation of the enterprise as a producing part of the American economy, is a target for the charge of "entrenchment" if it tries to ward off the destruction of all that.

In the main, defensive provisions have been beneficial to target shareholders and play an appropriate role in the takeover process. While no takeover defenses can or should make a target invulnerable to acquisition, they do provide target management a limited opportunity to defend against inadequate and unfair offers and to try to protect the interests of employees, customers and suppliers, and communities. They also provide targets with some leverage with which to negotiate for a higher offering price with takeover bidders.

First, takeover defenses have been an important means by which targets have attempted to curb abuses of other shareholders, employees, customers and suppliers, and communities. The profits made by raiders against their targets in recent years, the enormous fees earned by investment bankers in successful takeover bids, and the support for takeover activity provided by arbitrageurs and institutional investors all have kept the playing field heavily tilted against targets in takeover bids. The record shows that, without any defenses, the fate of every public corporation would be in the hands of raiders, investment bankers, arbitrageurs and other short-term investors. Companies would be taken over and their component parts sold off to anyone willing to pay somewhat more than the prevailing market price, even if the inherent value of the company is far greater. It is safe to say that most people would not welcome the disruption and economic dislocation that would occur.

Moreover, takeover defenses were not created in a vacuum; they have been designed to respond to abusive tactics invented by corporate raiders. For example, the development of two-tier tender offers, which even raiders such as Boone Pickens acknowledge can be coercive and unfair to target shareholders, has spawned "fair price" charter amendments which are designed to deter such offers. Fair price charter amendments are a clear case of a defensive measure that has benefited shareholders.

Second, the directors' fiduciary duty to shareholders limits any abuse of defensive measures. Critics of defensive measures charge that they only entrench management. This argument, however, ignores the importance of the directors' responsibility to the shareholders. The poison pill and most other takeover defenses rely upon the board of directors to make decisions in the best interests of the company and its shareholders. Unlike corporate raiders and arbitrageurs, the board of directors has a legally enforceable fiduciary duty to the shareholders. And, unlike the takeover players, the board of directors takes into account the interests of the wider community with a stake in the company's future.

Recent cases in Delaware and elsewhere confirm that, in a takeover context, courts will hold a target's directors to a heightened standard of care; thus, the directors must act in recognition of the very real threat of liability if they fail to meet that standard. A more complete discussion of the "business judgment rule" is included in this statement.

Most defensive measures, including shareholder rights plans, sometimes referred to as "poison pills," and many shark repellent charter provisions, contain "safety valves" which permit the board to disarm a defense in the face of a takeover offer that is in the shareholders' best interest. Because of these safety valves, the courts evaluate not only the adoption of such a measure, but also the directors' decision whether or not to defuse it. In the case of poison pills, courts scrutinize the decision whether or not to redeem the rights (effectively cancelling their defensive effect) in response to a particular offer. If the directors breach their fiduciary duty by refusing to redeem in response to a fair and adequate offer, they can be held personally liable to shareholders, or, at the very least, the courts will invalidate the rights.

When the Delaware Supreme Court upheld the power of the directors to adopt so-called poison pills in a leading case in November 1985, that court stated that the directors' decision whether or not to redeem the rights in the face of a particular takeover bid would be evaluated in light of the directors' fiduciary duty. Before and after that decision, courts have struck down a number of shareholder rights plans -- including most recently those of NL Industries and CTS Corporation -- which were not redeemed by the directors under circumstances where they could not fully justify their actions.

Thus, the real focus of consideration of most defensive measures should be on the circumstances at the time the measure is used or not used in a particular control contest. As the foregoing suggests, the evaluation of whether a defense should be permitted under particular circumstances is highly dependent on the particular facts. This is why, among other reasons, that Congress should not assume the states' traditional role of regulating such matters by making rules applicable to all cases. Unlike Congress, the courts are able to evaluate defensive measures on a case-by-case basis.

Third, defensive provisions benefit target shareholders. As stated previously, most defensive measures, including shareholder rights plans and many "shark repellent" charter provisions, contain safety valves which permit the board to defuse the defense in the face of a takeover offer that is in the shareholders' best interest. Because of these provisions, shareholders rights plans and other defenses give the board of directors greater negotiating power to get the bidder to offer a higher price to the shareholders.

For example, in February 1986, Westchester Financial Services was the subject of a hostile bid by Northeast Savings at $30 per share. After Westchester adopted a poison pill, Northeast commenced a tender offer for $33 per share. Three months later, Westchester entered into a transaction with Marine Midland at $53 per share immediately after Westchester redeemed their rights. In May 1986, Ex-Cell-O adopted a poison pill and, almost three months later, received an offer for $68 per share. Ex-Cell-O rejected the offer as inadequate, but later agreed to a revised offer of $77.50 per share.

In other cases, defensive measures that help keep a company independent can ultimately permit it to realize greater value for its shareholders. A recent Kidder Peabody study shows that, of 49 defeated tender offers in a 10-year period, the stock price of 92% of the companies surveyed reached a level (after adjustment for inflation) higher than that of the highest price offered in the tender offer.

Fourth, defensive measures do not stop takeovers. Many companies that have adopted poison pills have nevertheless been taken over. These companies include Associated Dry Goods, Crown Zellerbach, RCA, McNeil Corp., Eastern, AMSTED Industries, Cluett Peabody, Ex-Cell-O, Safeway, Sea-Land, Westchester Financial Services, Great Lakes International, Revlon, Victory Markets and William E. Wright. No poison pill or other defensive measure can make a company invulnerable to a takeover. If they did, the success rate of raiders in recent years and their resulting profits would not be so high: According to one recent study by Morgan Stanley, hostile takeovers now enjoy a 50% success rate (notwithstanding the fact that many of them are launched not to "succeed," but to extract greenmail or bring in white knights), compared with a previous success rate of approximately 20%.

B. The Role Of States

State legislatures and state courts have historically played the leading role in regulating internal corporate governance. State legislation in this area is supported by strong public policies, even when such legislation has an effect on takeover contests. The Supreme Court recognized many of these policy concerns when it upheld the Indiana Control Share Acquisition statute in *CTS Corp*. v. *Dynamics Corp. of America*, No. 86-71, slip op. (U.S. April 21, 1987).

Tender offers involve purchases and sales of securities traded in our national securities markets and, therefore, fall within the types of transactions traditionally regulated by the federal securities laws. However, they also effect fundamental changes in the ownership and control of target companies. As such, they are closely related to the types of transactions -- such as mergers -- that traditionally have been regarded as an appropriate subject for state corporate laws.

"Congress has never indicated that the entire corpus of state corporation law is to be replaced" by the federal securities laws.[16] Rather, a dual regulatory scheme was contemplated, in which the federal and state authorities share responsibility, each operating within their respective spheres of traditional authority. A fundamental role for states in corporate life has always been partially premised on "the fact," as noted by the Court in CTS Corp., "that state regulation of

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[16] *Burks* v. *Lasker*, 441 U.S. 471, 478 (1979).

corporate governance is regulation of entities whose very existence and attributes are a product of state law." Slip op. at 18. The regulatory sphere of state interest in the "internal affairs" of state chartered corporations also has been noted in other decisions by the Court:

> Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation.[17]

Corporate governance involves a balancing of rights and duties among directors, managers and shareholders, and it is state law that has traditionally assured that shareholders were treated fairly in transactions involving a change of control. Accordingly, state "corporate law has traditionally protected shareholders' rights by regulating the techniques of effecting change in the corporation's structure, such as the transfer and voting of shares, shareholder agreements and voting trusts, mergers, dissolutions, and the use of proxies."[18] The Supreme Court emphasized the importance of the states' role in this regard in *CTS Corp*., stressing the long-standing nature of state laws in this area and the states' legitimate interest in continuing to regulate such issues. *See* slip op. at 14-22.

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[17] *Cort* v. *Ash*, 422 U.S. 66, 84 (1975).

[18] Sargent, *On the Validity of State Takeover Regulation*, 42 Ohio L.J. 689, 724 (1981).

In the 200 years of corporate governance in America, the states have developed a comprehensive and balanced body of laws and extensive expertise in regulating the substantive and procedural aspects of corporate governance, including control matters. In contrast, the federal government has developed a body of law and expertise that relates primarily to disclosure in such transactions, and to certain other discrete aspects of tender offers. For example, the structure of the board of directors and the power of the shareholders to remove directors are matters exclusively of state law, although those laws have a significant impact upon the ability of a tender offeror, after acquiring a majority of stock in a company by tender offer, to seize control of the internal corporate machinery. Nevertheless, those laws were thought to be clearly constitutional. The trend of judicial decisions before *CTS Corp.*, however, threatened to render these statutes unconstitutional, since the principles under which the federal courts were striking down state laws in this area might well have applied to other state laws which have the effect of making more difficult the successful takeover of any company by tender offer. The Supreme Court recognized and rejected this possibility in *CTS Corp.*, writing that "[t]he longstanding prevalence of state regulation in this area suggests that, if Congress had intended to pre-empt all state laws that delay the acquisition of voting control following a tender offer, it would have said so explicitly." Slip op. at 15-16.

In addition to the specific requirements imposed by statute, states have regulated corporate governance matters by allowing judicial review of corporate conduct. Courts have considerable powers in this area through application of standards of conduct applicable to directors, management and shareholders.

In addition, the states provide a valuable opportunity for experimentation with different modes of regulation. Finding the proper balance between the competing interests affected by corporate takeovers poses an extremely difficult regulatory problem. And, as Justice Brandeis cogently observed over fifty years ago: "It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."[19] By permitting the states a role in this area, Congress obtains the benefit of the states' experiences in the continuing effort by both the federal and state governments to achieve a fair and efficient system of corporate and securities regulation. Moreover, because "[n]o principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations," there can be no undue burden on interstate tender offers caused by any need to comply with numerous different state regulatory schemes; each target company would be subject only to the corporate laws of its state of incorporation. *CTS Corp.*, slip op. at 18.

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[19] *New State Ice Co.* v. *Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

Not only do the states provide valuable laboratories for experimentation, they also can react more quickly than the federal government to changes in the tender offer process. The techniques used in takeover fights are constantly changing. The state legislatures are able to react more quickly to emerging problems than the federal government, and are thus better able to address such problems as they emerge in the takeover arena.

Finally, the states have a number of legitimate public policy interests in regulating the internal affairs of their corporations. As recognized by the Court in *CTS Corp*., "[a] State has an interest in promoting stable relationships among parties involved in the corporations, its charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs." Slip op. at 20. This not only protects shareholders, but also enhances investor confidence in the fairness and effectiveness of the state's corporate laws. The state also has an interest in corporations that make a substantial contribution to the life of the communities in which they exist. Corporations provide employment, a crucial tax base, provide and purchase goods and services, and supply leadership, volunteers and financial support for organizations promoting social welfare, the arts and other enrichments to the community. This will vary from case to case, but these are real interests; they derive from the corporation's reality as a tangible economic entity, and have much more validity than the presumed benefits of some currently fashionable economic theory.

C. *The Business Judgment Rule In Corporate Control Contests*

Some argue that the business judgment rule prevents courts from reviewing the actions of corporate directors and officers during a contest for corporate control. This is not the case. Rather, the courts closely scrutinize takeover defenses erected by target companies and, in a number of instances, have invalidated defenses where the target's directors and officers have not acted appropriately under the circumstances.

State corporate law has long recognized "the basic principle that corporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders."[20] In certain cases where a breach of this duty by a director or officer is alleged, the business judgment rule merely provides a presumption, which may be rebutted by plaintiff, "that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Unocal Corp*. v. *Mesa Petroleum Co*., 493 A.2d 946, 954 (Del. 1985), *quoting Aronson* v. *Lewis* 473 A.2d 805, 812 (Del. 1984).[21]

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[20] *Unocal Corp*. v. *Mesa Petroleum Co*., 493 A.2d 946, 955 (del. 1985). *See also Guth* v. *Loft, Inc*., 5 A.2d 503, 510 (Del. 1939).

[21] In many cases, however, the presumption will not protect directors and officers from liability. It will not be available, for example, where the action was not authorized by law, the action was undertaken for the sole or primary purpose of entrenching the actors in office, the officers or directors are shown to have acted fraudulently or in bad faith, or if the defendants are shown to have a financial interest in the decision and to have engaged in self-dealing.

State Law also has recognized that in the takeover context "there is a potential conflict of interest between the managers and [the] shareholders of the target."[22] This potential conflict has "seemed serious enough to warrant a more searching judicial review of corporate decisions concerning defensive measures to takeovers than of decisions concerning ordinary business decisions."[23] As a result, "courts are not simply to rubber stamp the board's judgment but must review it carefully to make sure that in adopting [a defensive tactic] the board really was acting in the best interests of the corporation." *Dynamics Corp of America* v. *CTS Corp*., 805 F.2d 705, 708 (7th Cir. 1986) (applying Indiana's rule).[24]

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[22] *Dynamics Corp. of America* v. *CTS Corp.*, 805 F.2d 705, 708 (7th Cir. 1986) (applying Indiana law).

[23] *Dynamics Corp. of America* v. *CTS Corp.*, 794 F.2d 250, 256 (7th Cir. 1986), *prob*. *juris*. *noted*, 107 S.Ct. 258 (1986) (only as to constitutionality of Indiana control share acquisition statute).

[24] Or, as the Delaware Supreme Court has put it: Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.

As applied by the Delaware courts, the leading jurisdiction in the area of corporate law, the business judgment rule now requires directors who adopt a takeover defense to "show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed," a burden which requires proof of "good faith and reasonable investigation,"[25] among other things. They must also prove that the defense was "reasonable in relation to the threat posed."[26] The defense must be authorized by law[27] and must not be undertaken "solely or primarily out of a desire to perpetuate [the directors or officers] in office."[28] Moreover, this analysis will be applied to a challenged takeover defense not only when it is adopted, but also when it is utilized by the target in connection with a particular tender offer.[29]

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[25] *Unocal Corp.*, 493 A.2d at 955. *See also Moran* v. *Household International, Inc.*, 500 A.2d 1346, 1356 (Del. 1985); *Revlon, Inc.* v. *MacAndrews & Forbes Holdings, Inc.*, [1985-86] Fed. Sec. L. Rep. (CCH) ¶ 92,525 at 93,146 (Del. 1986); *AC Acquisitions Corp.* v. *Anderson, Clayton & Co.*, [1986-87] Fed. Sec. L. Rep. (CCH) ¶ 92,942 at 94,600-02 (Del. Ch. 1986).

[26] *Unocal Corp.*, 493 A.2d at 955.

[27] *Id*. at 953-54.

[28] *Id*. at 955.

[29] *See Moran*, 500 A.2d at 1357.

The CHAIRMAN. Thank you, Mr. Atwater, for an excellent statement.

I might say Mr. Trowbridge is the president of the National Association of Manufacturers. We're delighted to have you, Mr. Trowbridge. Go ahead.

STATEMENT OF ALEXANDER B. TROWBRIDGE, PRESIDENT, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. TROWBRIDGE. Thank you very much, Mr. Chairman.

I also have a full statement which I would like to present for the record.

The CHAIRMAN. That will be printed in full in the record.

Mr. TROWBRIDGE. We very much appreciate the leadership and dedication which you and this committee have brought to the issue of tender offer reform and welcome this opportunity to testify concerning our views on S. 1323 and other legislation introduced by Senators D'Amato, Sanford, and Metzenbaum.

On April 3, 1987, the NAM adopted a proposal designed to close loopholes in the Williams Act and our proposal is very similar in focus to the bills now before this committee. For your further review, that proposal is attached to the formal testimony that we presented.

I'd like to stress that our goal is not to eliminate hostile takeovers, but to eliminate abuses in the takeover process. NAM members are often bidders and targets in the merger and acquisition scenario and consider properly conducted and economically sound hostile takeovers as a legitimate business practice.

Basically, what we are concerned with is the tender offer process, and at the same time the retention of the business judgment rule essentially in the hands of the State.

DISCLOSURE

In specific terms, regarding better disclosure, we feel that stronger and more enforceable disclosure standards must be created because during takeovers large profits can be reaped by taking advantage of other shareholders with information that should be public. Activities such as parking stock or churning stock and collusion all require secrecy or misinformation to succeed.

We believe that the most important disclosure provision in S. 1323 is the reduction of the 13(d) filing threshold from 5 percent to 3 percent and we would urge that indeed this filing threshold be further reduced down to a 1-percent level. It's far more difficult to conceal the ownership of stock than to conceal the existence of collusive agreements and intentions.

Adequate disclosure, especially in the earlier stage of a takeover, would result in fairer returns to the shareholders.

The NAM also strongly supports the other disclosure provisions in S. 1323, such as closing the 13(d) window and barring additional purchases during this period. We are in full agreement with stricter penalties for securities-related violations.

Regarding the discouragement of false reports, the purpose of section 13(d), we strongly support the Proxmire-Riegle provision requiring that an investor stand by the investment intent of his public 13(d) filing for a 6-month period. The 13(d) report as required under the Williams Act is intended to tell other shareholders the intended investment goals of the acquirer. This intent standard is really unenforceable. Raiders smile and wink when they announce they are purchasing for investment purposes, and the SEC can only throw up its hands for lack of proof to force a truthful disclosure of a raider's intent.

The investing public should be able to rely on these public statements for a reasonable amount of time.

Regarding unduly short minimum tender offer periods, S. 1323 extends the minimum tender offer period from 20 business days to 35 business days, an important improvement that will allow companies to explore other bids, consider restructuring possibilities, and bring better investment alternatives to their shareholders.

We recommend that the tender offer time period be further raised to perhaps 60 business days. Decisions that could affect hundreds, perhaps thousands of lives, merit this extra time.

Regarding manipulative takeover bids and other efforts to put companies in play, the current system rewards failure to complete the intended takeover. Putting companies into play has become a major investment game on Wall Street and this game is aimed at profiting from increases in stock prices during the tender offer process.

We recommend a requirement that anyone that puts a company into play by publicly announcing an intention to acquire that company return the profits, less expenses, to the target company if the stocks are sold within 6 months after terminating a takeover bid.

On "creeping tender offers," or "sweeping the street," or "two-tier" or partial offers, or "beachhead acquisitions," we support the provisions in S. 1323 which would bar anyone holding more than 15 percent of a company's stock from buying additional shares unless the purchase is through a tender offer open to all shareholders. This proposal would eliminate the abusive scheme known as "sweeping the street."

We suggest, however, that this threshold be lowered to perhaps 10 percent and further amended to require that purchases above 10 percent be made by a tender offer for the full company at 100 percent of the shares. This reform would eliminate the threat of two-tier and partial tender offers.

On preserving the State role, which we feel is highly important, we very much support the focus of S. 1323 which would improve Federal disclosure and enforcement under the Williams Act, while reaffirming the successful State role in the everyday mechanics of corporate governance law. Preserving the traditional State role is of vital importance to manufacturers. States have regulated in a sound and conscientious manner because they have important public policy interests, such as employment, a stable economic foundation, and the tax base.

In addition, under State law, shareholder and corporate rights are protected by independent judicial reviews and, where appropriate, Federal courts. The States have provided important flexibility and diversity impossible to duplicate at the Federal level, and they are fulfilling their role in our Federal system as flexible and responsive laboratories for the regulation of matters of non-Federal concern.

We strongly urge that this committee reaffirm the State role in tender offer legislation.

Fairness in the takeover market and greater opportunities for shareholders can be obtained better by a narrow legislative focus on improving disclosure and enforcement rules of the Williams Act. Other related issues, such as financing, ERISA reform, leveraged buyouts, which are controversial and need further study, should not be allowed to delay this legislation.

We look forward very much, Mr. Chairman, to working with you and the committee to pass Williams Act reform legislation that will return balance and fairness to the takeover process.

Thank you very much, sir.

[The complete prepared statement of Alexander B. Trowbridge follows:]

This rule reflects a judicial recognition that "officers and directors are the agents and fiduciaries of the shareholders and owe a duty of complete loyalty which is inconsistent with erecting insuperable barriers to hostile takeovers." Dynamics Corp., 794 F.2d at 254.[30] Applying the business judgment rule, the courts have accordingly struck down a number of takeover defenses erected by target managers, of which the following are only a few examples:

- The Seventh Circuit Court of Appeals, applying Indiana law, enjoined a shareholder rights plan -- the so-called "poison pill" -- in Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir. 1986).[31]

- The Second Circuit Court of Appeals enjoined a target company, SCM Corp., from granting a lock-up option to an investor group principally composed of officers of the target in Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264 (2d Cir. 1986).[32]

  The Delaware Supreme Court in Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., [1985-86] Fed. Sec. L. Rep. (CCH) ¶92,525 (Del. 1986), also invalidated a lock-up option granted by the target to a "white knight" bidder that had proposed a leveraged buyout which would have provided certain benefits to management.

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[30] The Delaware Supreme Court similarly has said: "A corporation does not have unbridled discretion to defeat any perceived threat by any Draconian means available." Unocal Corp., 493 A.2d at 955.

[31] A poison pill, briefly put, grants shareholders the right to purchase additional target or bidder stock if a change in control is threatened or takes place.

[32] Lock-up options give a third-party -- "white knight" -- bidder the right to buyer target assets.

- The Delaware Chancery Court enjoined a defensive self-tender offer by a target company for its own stock and a planned sale of target stock to an Employee Stock Ownership Plan ("ESOP") in AC Acquisitions Corp. v. Anderson, Clayton & Co., [1986-87] Fed. Sec. L. Rep. (CCH) ¶92, 942 at 94,603 (Del. Ch. 1986).

- In Norlin Corp. v. Rooney, Pace Inc., 744 F.2d at 255 (2d Cir. 1984), the target issued stock to a wholly owned subsidiary and an ESOP. The target's board of directors retained the power to control the voting of the newly issued stock, assisted it to ward off a potential acquisition. The Second Circuit enjoined the target from voting the stock in question.

- In Joseph E. Seagram & Sons, Inc. v. Abrams, 510 F. Supp. 860 (S.D.N.Y. 1981), a federal judge ordered a target not to go forward with a plan to sell off the company's assets in order to defeat a hostile tender offer, pending further proceedings.

- In Minstar Acquiring Corp. v. AMF, Inc., 621 F. Supp. 1252 (S.D.N.Y. 1985), the court enjoined amendments to an employee stock option plan, increased employee retirement benefits and increased severance allowances which a target had adopted to defeat an acquisition.[33]

The business judgment rule thus has not insulated takeover defenses from judicial scrutiny, as some have claimed. Rather, judicial scrutiny has been close and exacting. That is not to say, however, that the courts regard all defenses as invalid or require directors to remain passive in the face of a tender offer. Indeed, the courts have recognized that the decision to accept or reject a bid "necessarily rests with the board of directors, since it is the directors, and not the shareholders, who are best able to evaluate the numerous and often complex financial factors which must be considered in determining whether the takeover proposal is in the best interests of the corporation." *Enterra Corp.* v. *SGS Associates*, 600 F. Supp. 678, 686 (E.D. Pa. 1985).

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[33] The court also enjoined the target's poison pill plan, but without reaching the issue of whether the plan was protected by the business judgment rule.

But the law does not require the board to unthinkingly accept a bid or to remain passive in the face of a bid. "Once [the board] determined that a Care [Corp.] takeover would be detrimental to [the target] Treadway, it was . . .reasonable that the directors should move to oppose it." *Treadway Cos., Inc.* v. *Care Corp.*, 638 F.2d 357, 381 (2d Cir. 1980). Indeed, the courts have established an affirmative "duty of directors to evaluate proposed business combinations on their merits and oppose those detrimental to the well-being of the corporation even if that is at the expense of the short-term interests of individual shareholders." *Panter* v. *Marshall Field & Co.*, 646 F.2d 271, 299 (7th Cir. 1981), *cert. denied*, 454 U.S. 1092 (1981).

When a target company's board of directors determines that a tender offer should be resisted, the courts thus closely scrutinize that decision and carefully weigh all the facts and circumstances to judge whether the directors have acted appropriately in that particular situation. Where the board was justified in its action, the action will be upheld. But directors and officers who adopt defensive measures act in the very real risk that the courts will strike down the defense, and even at the risk of personal liability in some cases, if they act inappropriately. The merits of a defense may initially be an issue for management, but it is the courts who have the last word.

D. ERISA

Excess Pension Plan Assets

We recommend that the proposed legislation include a provision that would prevent a company from transferring excess pension plan assets from a plan to the company's general coffers for a period of 5 years from the date on which the company or its parent has undergone a change of control, whichever is later.

In recent years, there have been a number of instances in which an acquiring company has utilized funds of a target company's pension plans to partially finance the acquisition. This occurs when, following an acquisition, the acquiror terminates one or more of the target's pension plans and transfers the excess plan assets into the target's general operating funds, which moneys the acquiror then uses to pay down acquisition-related debt.

Some examples include the following: Mobil, which obtained $29 million from the Superior Oil fund; Pantry Pride, $88 million from Revlon's; Irwin Jacobs, $97 million from AMF's pension fund, nearly 20% of the total purchase price; Texaco, $250 million from the Getty fund; Occidental, $400 million from the Cities Service pension fund.

Although current law requires acquirors to leave sufficient assets in terminated plans to fund, on an actuarially determined basis, already earned benefits, it does not mandate that the excess assets be left in place to provide benefits to be earned in the future or to provide a cushion in case the actuarial assumptions and calculations prove to be too optimistic or there is a later shrinkage in the value of the plans' assets. Thus, not only are employees of a target subject to termination or forced resignation following an acquisition, but also the assets of the pension plans which would provide them their earned benefits in such event are being stripped after such acquisitions, leaving them with only the minimum mandated amount of assets to protect those benefits. As a consequence, they have no cushion to protect them if the plans' investments falter or the entity which results from the merger is forced into bankruptcy during an economic downturn.

The proposed amendment would provide employees with a five-year period following an acquisition during which the full amount of excess assets in their pension plans at the time of an acquisition would remain in such plans to provide a cushion in case the acquisition proves to have been ill-considered or ill-timed, or in case the value of the plans' assets decline during such period. It would thus help ensure that they do not suffer a loss of already earned retirement benefits solely because a raider wanted to acquire their former employer.

Fiduciary Duties And Tender Offers

We think the Committee should adopt legislative language that would permit employee benefit plan trustees in discharge of their fiduciary duty to consider the long-term benefits of continued stock ownership in the event of a tender offer

The Employee Retirement Income Security Act ("ERISA") is silent with respect to the fiduciary duty plan trustees in the face of a tender offer. It currently requires that plan fiduciaries discharge their duty with the care of a "prudent man" and "solely in the interest" of the plan's participants and beneficiaries. Thus, in the face of a premium, plan trustees may find themselves with no recourse but to tender the shares of the target company.

This required response is arguably a source of institutional investors' "short-time horizons" and, because of their recognized dominance of the market (accounting in 1985 for approximately 45% of public stock ownership), contributes to corporate managements' preoccupation with short-term earnings at the expense of capital investment, research and development, and other long-term goals.

We would suggest an amendment that provides a safe harbor for plan trustees and other fiduciaries who have no conflict of interest if they decide not to tender stock. Liability in such circumstances would require a showing of gross negligence or willful malfeasance.

IV. Conclusion

This concludes the statement for the record. The Business Roundtable and its members thank the Committee for affording us the privilege and opportunity to testify.

TESTIMONY OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

ON S. 1323 AND RELATED BILLS:
S. 227, S. 678, S. 1264, S. 1324

BEFORE THE SENATE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

JUNE 25, 1987

Mr. Chairman, members of the committee, I am Alexander B. Trowbridge, president of the National Association of Manufacturers (NAM). The NAM greatly appreciates the leadership and dedication you and this committee have brought to tender offer reform. We welcome the opportunity to testify today concerning the NAM's views on S. 1323 and related bills, S. 227, S. 678, S. 1264 and S. 1324.

Mr. Chairman, the NAM vigorously supports the legislative approach of improving disclosure and enforcement within the Williams Act while reaffirming the successful state role in the everyday mechanics of corporate governance law. Your bill, S. 1323, achieves this balance and expressly reaffirms the state process.

I want to stress that the NAM's goal is not to eliminate hostile takeovers but to curtail manipulative abuses and increase fairness in the takeover process. NAM members are often bidders and targets in the takeover scenario and consider properly conducted and economically sound hostile takeovers as a legitimate business practice. Our members want the minimum

amount of federal and state regulation. We believe that hostile takeover abuses can be corrected by requiring enforceable disclosure standards and by eliminating a number of manipulative takeover schemes. We believe that the recent spate of indictments exposing the greed and amoral attitude of some "Wall Street" players is an indictment of a system that has failed. The easy money to be made in the unfair takeover game has led indirectly to a breakdown in morality of some people whose stock-in-trade used to be honesty and fair dealing.

On April 3, 1987, the NAM adopted a proposal designed to close loopholes in the Williams Act. I would like to discuss the general approach of NAM's proposal and related proposals contained in S. 1323 and other bills. For your further review, the NAM proposal is attached to my testimony.

I. INADEQUATE REPORTING OF STOCK ACCUMULATIONS

The NAM urges that enforceable disclosure standards be created. Many takeover abuses arise from weak and unenforceable Williams Act disclosure rules. During takeovers, large profits can be reaped by utilizing information that should be public to take advantage of other shareholders. Activities such as parking stock, churning stock and collusion all require secrecy or misinformation to succeed. These activities are sophisticated ripoffs perpetrated on the American shareholder and general public.

The NAM supports reform provisions in S. 1323 and other related bills which clarify and refine existing law on collusive activity. The NAM supports closing and barring additional purchases during the 10-day time period (also known as the 13(d) window) during which the bidder, under current law, must report his acquisition intentions to the SEC and the investing public. We also applaud provisions for stricter penalties and prison sentences for securities-related violations. These are important reforms, but by themselves do not address a basic disclosure deficiency in the Williams Act. Numerous collusive activities now can be hidden behind insufficient information about stock ownership.

More information is necessary. Key provisions in S. 1323 would achieve better disclosure by reducing the 13(d) threshold from five percent to three percent, and in S. 1324 by lowering the threshold to two and one-half percent. The NAM supports lower disclosure standards and further urges that the threshold be lowered to one percent. Increasing the disclosure of stock ownership will make it far more difficult to conceal the existence of collusive agreements and intentions. Stronger disclosure standards on stock ownership will discourage manipulative takeover schemes. And adequate disclosure, especially in the earlier stage of a takeover, will result in fairer returns to shareholders.

The NAM also urges inclusion of institutional investors in this reporting requirement because they can be major players in takeovers, although their threshold should be set higher, such as

at two percent. We support provisions requiring that additional acquisitions of one percent also be reported.

To eliminate intentional churning of stock schemes, we recommend that the bill require the reporting of any cumulative trading up to two percent of a company's stock within a 90-day period.

Will such information dramatically increase paperwork? The NAM has put this issue to its own test. We asked our members -- many of whom have extensive investment activities -- to consider the impact. The consensus was that paperwork will not increase significantly if the required information is carefully limited. The 10-day window provision came into effect when much of the paperwork was exactly that: paperwork. Today, it is computer work.

The NAM also suggests that the large acquisitions of institutional investors now reported to the SEC should be treated as public information rather than confidentially. This would require no additional paperwork. We also recommend that investors filing 13(d) reports make known their germane conversations regarding a given target company with other investors also filing 13(d) reports on that company. This would place a duty on takeover players to report collaborative stock accumulations that are not based on prior agreements or understandings. All these proposals are aimed at putting shareholders and management in a better position to evaluate a takeover bid.

II. FALSE STATEMENTS OF PURPOSE IN SECTION 13(D) REPORTS

The NAM strongly supports the Proxmire-Riegle proposal requiring that an investor stand by the investment intent of public 13(d) filing for 6 months.

The 13(d) reports as required under the Williams Act are intended to tell other shareholders the intended investment goals of the acquirer. This intent standard is totally unenforceable. Raiders smile and wink when they announce they are purchasing for investment purposes. The SEC can only throw up its hands for lack of proof when attempting to force a truthful disclosure of a raider's intent.

Changes in corporate control are important events in the growth or demise of a corporation. They have a dramatic impact on shareholders' investments. Federally required 13(d) announcements on which the investing public relies should impose on the raider a responsibility that does not exist in current law. The Proxmire-Riegle proposal creates just such a responsibility. This requirement would not harm legitimate bidders but would reveal important information to the investing public.

III. UNDULY SHORT MINIMUM TENDER OFFER PERIOD

S. 1323 extends the minimum tender offer period from 20 business days to 35 business days. The NAM believes this is a step in the right direction, but still is not enough. More time would be a very important improvement in the tender offer process that will allow companies to explore other bids, consider restructuring possibilities and bring better investment alternatives to shareholders. It would help reduce significantly unfair takeovers that succeed solely on the basis of insufficient response time. This would be an important benefit for all corporate constituencies. Unfair hostile takeovers are a serious problem for American industry because of the increased debts they place on the targeted corporations.

The NAM recommends that the tender offer time period be raised from 20 business days to 60 business days because business days is the current standard and avoids the problem of not counting weekends and holidays. The growth of companies depends on sound business decisions being made by management in conjunction with its shareholders. Decisions that could affect hundreds, maybe thousands of lives, merit sufficient time to weigh the alternatives.

IV. MANIPULATIVE TAKEOVER BIDS AND OTHER EFFORTS TO PUT COMPANIES IN PLAY

The current system rewards failure. The raider's failure to accomplish his alleged intent to take over a company far too often is rewarded by millions of dollars. NAM believes failure deserves no such rewards. Because of the lack of timely information and the penalties, current rules encourage spurious takeover bids that are aimed at profiting from increases in stock prices during the tender offer process. By putting a company into play, the raider can often increase the stock prices by 30 percent or more. By reselling the stock later at market price, or through greenmail, the raider can reap huge profits. The NAM believes such fraudulent takeover bids should be discouraged.

The NAM recommends that anyone who puts a company "into play" by publicly announcing an intention to acquire that company return the profits (less expenses) to the target company if the stocks are sold within six months after terminating a takeover bid.

V. CREEPING TENDER OFFERS, SWEEPING THE STREET, TWO-TIER AND PARTIAL OFFERS AND "BEACHHEAD" ACQUISITIONS

NAM supports the provision, contained in S. 1323, that would bar anyone holding more than 15 percent of a company's stock from buying additional shares unless the purchase is through a tender offer open to all stockholders. This proposal would eliminate the current practice known as "sweeping-the-street." This term describes the scenario whereby the raider announces a tender offer and the arbitrageurs accumulate large holdings in the company. The raider then cancels the tender offer and purchases controlling shares of the company from the arbitrageurs. The Hanson Trust acquisition of SCM corporation was accomplished by this method.

The NAM suggests, however, that this provision be amended to require that purchases above 10 percent be made by a tender offer for 100 percent of the shares except for specified exceptions. Senator Sanford's bill, S. 1324, requires this at the 20 percent threshold. This reform would address two-tier and partial tender offers. Historically, two-tier and partial tender offers have been used by raiders to deprive shareholders of their _pro rata_ opportunity to sell their stock at the highest price. While the NAM recognizes that recently fewer two-tier and partial tender offers have been occurring, their potential as a manipulative takeover tactic has not diminished. NAM's recommended change will ensure that all shareholders are permitted to share in the takeover premium.

VI. PRESERVING THE STATE ROLE

Of utmost importance to the manufacturing community is the preservation of the state role in corporate governance law. S. 1323 and S. 1324, both by express language and by the implied scope of the bills, do acknowledge the importance of the dual federal/state roles.

Reasons for preserving the traditional state role are vital to manufacturers. The states have provided a stable environment for corporations to grow by focusing on the mechanics of the development of the corporation. They have regulated in a sound and conscientious manner because they have important public policy interests such as employment, a stable economic foundation and a tax basis. Sanctions are imposed by the states when their rules are violated. In addition, under state law, shareholder and corporate rights are protected by independent judicial review and, where appropriate, federal courts. The states have provided important flexibility and diversity impossible to duplicate at the federal level. They are fulfilling their role in our federal system as flexible and responsible laboratories for the regulation of matters of nonfederal interest.

The NAM has serious concerns with recent efforts by the Securities and Exchange Commission to extend its authority and preempt traditional state jurisdiction over corporate governance matters. The SEC has advocated publicly the short-term benefits of hostile takeovers and has opposed actively tactics that slow takeover activity. Milton Cohen, head of the SEC's Special Study of the Securities Markets (1961 through 1963), stated in testimony on February 24, 1987 before the Securities Subcommittee of the Senate Committee on Banking, Housing and Urban Affairs that

> "with a few significant exceptions, the Commission has been tolerant of innovative, aggressive tactics on the bidder side as being in furtherance of, or at least consistent with, a flourishing 'market in corporate control,' whereas at the same time the Commission has not supported, or has actively opposed, various novel defensive tactics as being detrimental to the 'market in corporate control.'"

If the hand of the states is removed from this arena of law, and takeover defenses are curtailed through SEC action, then the future of many public corporations will be at the mercy of arbitrageurs and the short-term requirements of institutional

investors. Properly conducted defense tactics are the only hope for corporations against coercive and collusive takeover bids initiated for the sole purpose of enriching the raider to the detriment of the targeted company, its employees and shareholders. Removal of these defense measures will make U.S. companies vulnerable to any bids above the prevailing market price, even when their own real asset value is far greater. In light of international competition, it would be atrocious public policy to force on American manufacturing such short-term adverse pressures.

The NAM supports provisions in S. 1323 and S. 1324 which reaffirm the state role. The NAM urges that this committee take a strong stand for state oversight of traditional corporate governance law.

VII. FOCUS REFORM ON DISCLOSURE, ENFORCEMENT AND FAIRNESS IN THE WILLIAMS ACT

The NAM recommends that any reform of many related economic issues such as financing, community impact statements, ERISA reform, and leveraged buyouts be considered separately by this committee. These issues, many of which are controversial and need further study, should not complicate Williams Act reform proposals.

Fairness in the takeover market and greater opportunities for shareholders can be obtained best by a legislative focus on improving disclosure and enforcement rules. Reform should be achieved this year without further study of related issues.

The NAM looks forward to working with you to draft and pass Williams Act reform legislation that will return balance and fairness to the takeover process.

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NAM PROPOSAL ON TENDER OFFER REFORM

TAKEOVER ABUSES AND PROPOSALS FOR REFORM

1. Inadequate reporting of stock accumulations. Corporate raiders today are able to establish a "beachhead" in a target's stock by accumulating a substantial position before reporting their holdings and their intentions to the SEC, investors and management pursuant to Section 13(d) of the Securities Exchange Act. Icahn, for example, was able to accumulate more than 20% of TWA's stock before filing any report under that Section. In some cases, such reports are avoided by the raider's acting in secret collusion with arbitrageurs, investment bankers or institutional investors; by keeping each player's stake at less than the 5% reporting threshold under that Section, and by not admitting that they are acting together as a "group," they can accumulate a substantial block before they file any report. Shareholders who sell to such persons are unfairly deprived of any part of the control premium if a takeover proceeds.

Proposed Solutions:

- Reduce the Section 13(d) reporting threshold from 5% to 1%.

  [Under this approach, each collaborator would be required to report his own significant holdings, and there would be no need to detect or prove the existence of a "group."]

- Reduce the reporting threshold for passive institutional investors qualified to file Schedule 13G reports from 5% to 2% and require such reports to identify transactions (date, price, number of shares purchased or sold) within the prior 60 days.

- Require that Schedule 13D and Schedule 13G reports be filed within 2 business days after the applicable threshold is crossed. This requirement may be met by filing a short form report (disclosing only the number of shares beneficially owned, the identity of the beneficial owners and, by checking boxes, the purpose for which the shares were acquired) provided that the full report is filed within 10 days after the threshold is crossed. Further purchases would be barred between (i) a single transaction by which the person crosses the threshold and (ii) the end of the first business day following the day on which the report (or the short form if used) is filed, or, if later, is delivered to the issuing company.

  [This would close the so-called "10-day window," within which raiders are able to accumulate an unlimited amount of stock before they are required to report their holdings and their intentions. Current law requires initial Schedule 13D reports to be filed 10 days after crossing the threshold, and requires Schedule 13G reports to be filed 45 days after the end of the calendar year in which the threshold is crossed and must be updated annually.]

- Additional increments of 1% must be reported by amendment to the Schedule 13D or 13G report within no more than 2 business days. When the reporting person or group acquires 5%, further purchases would be barred between (i) a single transaction by which that level is achieved and (ii) the end of the first business day following the day on which the amendment reporting such acquisition is filed, or, if later, is delivered to the issuing company.

> [The current requirement is to amend Schedule 13D "promptly" after increasing beneficial ownership by 1% or more.]

- Require reporting under Section 13(f) of stock transactions cumulatively exceeding 2% of the outstanding shares during any 90-day period by any institutional investor managing more than $10 million, such reports to be filed within 2 business days after transactions cumulate to that level. (Current requirement applies only to managers of $100 million or more and merely requires reports 45 days after the end of each calendar quarter of holdings on the last day of the quarter.)

> [There is growing evidence that institutional investors participate in efforts to put companies in play by using their substantial resources to create the appearance of a takeover interest in a company. This provision would bring to light heavy institutional investor as well as arbitrageur trading in a particular stock, even if the institutional investor does not at any one time hold enough stock to require the filing of a Schedule 13D or 13G report. The lower reporting threshold as to funds under management will include many more arbitrageurs than are currently required to report.]

- Schedule 13D reports should disclose communications within 60 days between the filing person and any other person filing a Schedule 13D or Schedule 13G report if such communications relate to transactions or planned transactions in the issuer's securities or either party's intentions as to the issuer or its securities. In either case, the disclosure should include the fact of such a communication and its general subject matter, but need not include the content of the communication.

> [This provision, together with the reduction in the threshold for reporting pursuant to Section 13(d), is intended to provide disclosure of circumstances in which collaborative stock accumulations are made by persons who do not admit that they are a "group." Current law requires the existence of an agreement or understanding for there to be a "group" required to report their combined holdings, and current disclosure rules only require disclosure of agreements, arrangements or understandings with other persons. Under this proposal, Icahn and Boesky would have been required to have reported their contacts with one another in connection with the Phillips Petroleum and Gulf & Western matters, in which it has been said that they collaborated in the accumulation of a large block of stock, without the need to prove that they had any prior agreement or understanding.]

- Confidential treatment should not be given to Section 13(f) filings by institutional investors with respect to any holdings exceeding 2% of the outstanding shares of any company.

> [Confidential treatment of quarterly reports by institutional investors as to their holdings under Section 13(f) is routinely granted by the SEC upon request. Such investors' need for confidentiality of their investment strategy is clearly outweighed by the market's need to know when such investors become substantial shareholders. This provision might be mooted if the 2% reporting threshold for Schedule 13G is adopted.]

- Impose a penalty for delinquent or materially false filings of Schedule 13D or Schedule 13G or Section 13(f) reports. The amount of the penalty should be the greater of (i) 1% of the value of the shares held or traded for each day that the report is late or false, or (ii) the difference between the highest market price of the shares during the 10 trading days after the filing of a late, or correction of a false, report and the lowest market price of the shares between the date on which the filing was required and the date on which it was made. The penalty would be payable to the SEC, and either the SEC or the issuing company would have standing to sue for the penalty, by showing that the delinquent or false report was not inadvertent. If the issuing company collects the penalty, it would be entitled to retain its legal fees and expenses out of the recovery.

> [The penalties for failing to file, or filing a false, Section 13(d) report are extremely mild, typically only an injunction requiring compliance. Shareholders who sell their stock without knowing of the raider's takeover intentions have difficulty suing under current law for their damages. Such a penalty would provide a needed deterrence to such false or delinquent reporting.]

2. False statements of purpose in Section 13(d) reports. Some raiders accumulate a substantial block of the target's stock and file the required Section 13(d) report, but falsely state that they are purchasing "for investment purposes." After they have accumulated a sufficiently large block of stock, at low prices as a result of their failure to disclose their true intentions, they then announce those intentions, namely a takeover bid. For example, Boone Pickens has been found to have filed false Schedule 13D reports claiming an investment intention, both in connection with his bid for Gulf Oil and in connection with his bid for Unocal.

Proposed Solution:

- Bar anyone claiming an investment purpose in a Section 13(d) report from making a tender offer for 6 months after an amended Section 13(d) report discloses an intention to seek control, unless such person can demonstrate, either in court or by obtaining an SEC waiver of the bar (the request for which and proceedings in connection with which will be on the open record), that there has been a "change of circumstances" justifying a bona fide change in the person's initial investment intentions.

3. Unduly short minimum tender offer period. The current minimum tender offer period of 20 business days leaves management and shareholders too little time in which to respond and make decisions of great consequence. There is little time to explore alternatives, and targets are increasingly responding with their own counteroffer to shareholders, financed by increased debt levels which leave targets financially weakened. The resulting competing offers are sometimes so complex that small shareholders are left bewildered and left out.

Proposed Solution:

- The minimum tender offer period should be extended to 60 business days.

4. Manipulative takeover bids and other efforts to put companies in play. Current rules encourage spurious tender offers, which are conditioned upon the offeror's obtaining financing, or public announcements that a person has accumulated a large block of target stock and intends or is considering making a tender offer. This ploy is used by greenmailers and raiders to create instability in which the perpetrator hopes to be bought out by the target, a white knight or another bidder drawn into the action and has no real intention of attempting to take over the company.

Proposed Solution:

- Any person who commences a tender offer or makes a public announcement of an intention to seek control of a public company (the "Covered Person") should be required to disgorge to the target company any profits (less reasonable expenses) realized from the disposition of shares acquired less than 6 months prior to such tender offer or announcement if those shares are disposed of within 6 months after the commencement of such offer or making of such an announcement. Professional fees will not be deemed reasonable if they cover services beyond traditional advice and assistance of financial, legal or other professional advisors. The SEC would have the power to exempt transactions by rule or regulation or, upon application, by order.

  [This proposal is parallel to Section 16(b) of the Securities Exchange Act, which for 50 years has required corporate officers and directors to disgorge to the company their profits from purchasing and selling company stock within a 6-month period. Persons who seek control of a company, or publicly state an intention to do so, would in effect be treated as insiders subject to a similar requirement. Among other things, greenmail would no longer be profitable because the greenmailer would have to give up his profit to the company.]

5. Creeping tender offers, sweeping the street, two-tier and partial offers and "beachhead" acquisitions. In some cases, takeovers have been effected by rapid and secret open-market purchases of enough stock to give the purchaser control. In other cases (called "sweeping the street"), a tender offer is made and then, after the arbitrageurs have accumulated enormous blocks of the target's stock, the offeror has withdrawn the tender offer and has purchased enough stock from the arbitrageurs to give the raider control of the target. In either case, shareholders are deprived of the pro rata opportunity to sell their stock and share in the control premium that the Williams Act intended and that is required in the case of a tender offer.

Proposed Solution:

- Any acquisition which would give the holder 10% or more of a company's stock may only be made by a tender offer for 100% of the shares. The issuing company would have standing to enforce this requirement.

[This proposal would ensure that all shareholders are permitted an equal opportunity to share in a control premium offered when a purchaser is seeking to acquire a control block of stock. In one fell swoop, this proposal would do away with the following takeover abuses

- "creeping tender offers," in which no tender offer is made at all, but the raider simply accumulates a controlling interest through open-market and privately negotiated purchases (this is how Icahn took control of TWA);
- "sweeping the street," in which the bidder buys a control block from the arbitrageurs, depriving the other shareholders of the opportunity to share in the control premium (this is how Campeau Corp. acquired control of Allied Corp.);
- partial and two-tier tender offers, which have an extra element of coercion in that shareholders who do not tender risk being deprived of any part of the control premium (Pickens' bid for Diamond Shamrock was a two-tier offer, although unsuccessful); and
- "beachhead" acquisitions would be limited to 9.9% before a raider would be required to make a tender offer (Harold Simmons acquired 20% of NL Industries before making a tender offer for its stock).

Recognizing situations in which these abuses might not occur in connection with acquisitions above 10%, however the proposal contemplates the following exceptions.]

Exceptions --

(1) acquisitions by intra-family transfer, inheritance or gift and similar acquisitions by operation of law or beyond the control of the acquiring person, and acquisitions following an event which diluted the acquiror's percentage ownership, provided that the acquisition does not result in a higher percentage of ownership than before the dilutive event;

(2) acquisitions approved in advance by the board of directors of the issuer;

(3) acquisitions of revocable proxies to vote shares of the issuer;

(4) the acquisition from a single person or group of a block of at least 10% which had been held by the same person or group for at least 2 years, or which was held upon the effective date of this act or upon the effective date of the initial registration of the subject securities pursuant to Section 12 of the Securities Exchange Act, provided that the acquiring person acquires no other shares of the issuer's stock within 6 months prior to or following the acquisition of such block;

(5) the acquisition of not more than 2% in any year, provided that (i) the acquirer has not acquired more than 1% in the 2 years prior to the first such acquisition, (ii) the acquirer has not acquired more than 2% in the 1-year period prior to any other such acquisition and (iii) no more than 5% in the aggregate may be acquired pursuant to this exemption;

(6) any tender offer would be exempt from the requirement that it seek 100% of the shares if the offeror undertakes in its offering documents to purchase or otherwise acquire all of the remaining shares within 12 months after termination of the partial tender offer, at the same price including an interest factor, in the same form of consideration, and on other terms and conditions at least as favorable as those provided for in the partial tender offer; or

(7) any acquisition exempted by the SEC by rule or regulation, or, upon, application, by order.

9. Ousted State role. Because of court decisions holding State laws unconstitutional which impede the making of a tender offer, the States are at risk of being ousted from their traditional role in corporate governance matters. What is needed is a federal statute reaffirming that State role.

The CHAIRMAN. Thank you, Mr. Trowbridge. Senator Domenici has come.

STATEMENT OF PETE DOMENICI, U.S. SENATOR FROM THE STATE OF NEW MEXICO

Senator DOMENICI. Thank you very much, Mr. Chairman. I appreciate your accommodating me and I apologize for being late. I couldn't get out of another committee in which one of our New Mexico bills was being considered. I thought I could but it just didn't finish.

I have a rather lengthy statement. I think I will just ask you to make it a part of the record.

The CHAIRMAN. We'd be happy to do that. It will be printed in full in the record.

Senator DOMENICI. I think it's fair to say when I first became concerned about the role of junk bonds in corporate takeovers several years ago, some suggested that I was an economic "Chicken Little" because I expressed some concern about the default rate of junk bonds and the troubles that savings and loans could get into with junk bond investments.

Well, I'm here to tell you that, while the sky hasn't totally fallen in, I think it has begun and I think it will fall further. Junk bond defaults are up dramatically. There were over $3 billion worth of junk bond defaults last year and I believe that will continue. We have seen one savings and loan lose $10 million in the junk bond market.

Let me suggest that I am not here today to discuss the broad issue of takeovers. I have my views with reference to that phenomenon and some of the things that I think were good about it, and some of the things that I think were very bad about it during the past 6 or 7 years. I would prefer today to talk specifically about junk bonds and how they apply to certain of our insured institutions—I have some recommendations with reference to what I think we ought to do.

In 1981, there were about $1.7 billion worth of junk bonds issued. In 1986—this isn't current but it's the best I could get—there were about $34.3 billion worth of junk bonds issued. That's a 20-fold increase. Per se, it means nothing. It's just a number. Nonetheless, I give it to you. Over 40 percent of these junk bonds are used to finance mergers and acquisitions, to the best I can find, primarily hostile takeovers.

Last year, the Federal Reserve took a small step toward curbing one of the most abusive tactics in corporate takeovers. That's the use of junk bonds to finance takeovers. The Fed said that the use of junk bonds to finance takeovers which are conducted through shell corporations with no asset base of their own is subject to the margin rule. The Fed concluded that they were really using the assets of the corporation that they were going to take over as security for the transaction which they considered to be a loan in applying the margin rule.

This ruling was made because these shell corporations had no assets with which to secure the loan except the stock of the target company. Therefore, the Fed determined, as I indicated, that junk bonds were loans indirectly secured by margin stock and thus subject to the margin requirement.

This ruling has not led to a drop in the amount of junk bond uses to finance takeovers. Rather, the corporate takeover artists have simply changed the way junk bonds are used to finance takeovers. More junk bonds are being issued by the acquiring companies themselves, rather than shell corporations, to facilitate takeovers and circumvent this ruling.

In March 1985, the Federal Home Loan Bank Board conducted a study and found that FSLIC-insured institutions and their subsidiaries held about $5.1 billion worth of junk bonds. At the end of last year, it was estimated that their holdings had increased to $7.6 billion. One savings and loan has about $2.3 billion, 28 percent of its assets, in junk bonds.

Now junk bonds have a higher average return, but they also have a higher default rate. From January 1, 1980 through last August, the total average default rate of junk bonds stood at 3.4 percent. The default on new-issue junk bonds, those bonds issued as junk bonds, is about 11 percent. There's been over $5 billion worth of junk bond defaults since 1980. The dollar value of junk bond defaults skyrocketed in 1986 when it exceeded $3 billion for the first time ever, and there were at least 28 junk bond defaults in 1986.

The Beverly Hills Savings and Loan suffered $10 million in losses from its investment in junk bonds. Beverly Hills invested in junk bonds after incurring huge losses in the real estate market as a last ditch attempt to raise income and then lost $10 million. This is the danger as I see it for unstable institutions. They will be attracted to the higher yields as a way of bailing out their financial difficulties. And to the extent that they succeed, that's fine. To the extent that they fail, they placed a inordinate risk upon the insuring agency—which is basically the rest of the insured institutions in this country.

Currently, national banks may invest an amount not in excess of 5 percent of the bank's capital and surplus in junk bonds, so long as the exercise of prudent banking judgment is used to determine that the issuer of the junk bonds will be able to meet its obligations.

Federal thrifts may invest up to 10 percent of their assets in junk bonds if they classify them as commercial loans. Otherwise, they may acquire junk bonds in an amount up to 1 percent of its assets if in the exercise of prudent business judgment they determine there is adequate evidence that the insurer will be able to meet its obligations, including debt servicing.

These restrictions do not apply to all federally insured institutions. State-chartered banks and thrifts are not subject to these restrictions. State-chartered institutions can invest in junk bonds without any Federal restrictions, even though the Federal Government insures them.

I believe it's time that we treat both federally chartered and State-chartered the same. I think it's unfair that the FDIC and FSLIC should be called on to insure junk bond speculation if the restrictions on federally chartered institutions make sense. And if they don't, you ought to take them off. I think they do make sense and that State-chartered institutions that benefit from the FDIC and FSLIC guarantees should be subject to the same limitations as are federally chartered institutions.

Additionally, there are no limitations on which institutions can own junk bonds. Only institutions that meet certain minimal net worth requirements should be permitted to do so.

I will shortly introduce legislation that would do the following:

Subject all federally insured banks and thrifts to the same limitations on junk investments that now apply to nationally chartered banks and nationally chartered thrifts.

Allow the FDIC and the FHLBB to waive these limitations if the institution demonstrates the investment in junk bonds would be consistent with the exercise of prudent banking or business judgment.

Prevent all federally insured financial institutions from investing in junk bonds if their ratio of primary capital to total assets or net worth is less than 6 percent.

Amend ERISA to limit the amount of junk bonds that a pension fund can invest in to 10 percent of that fund's portfolio. Ensure that the Federal Reserve margin requirement is applied to a junk-bond-financed takeover as a matter of statute law rather than regulation by the Federal Reserve.

Mr. Chairman, I know you have many distinguished witnesses that are far more expert in economics and business than I, and I know you will hear much pro and con about the whole area of takeovers. I thought that I might just share this aspect of it with you and suggest that there's room for some reasonable legislation in this area. And I thank you for accommodating me.

[The complete prepared statement of Senator Domenici follows:]

STATEMENT OF
SENATOR PETE V. DOMENICI
BEFORE THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

JUNE 25, 1987

MR. CHAIRMAN,

THANK YOU FOR INVITING ME TO SPEAK BEFORE THIS COMMITTEE TODAY. LET ME COMMEND YOU ON TAKING THE INITIATIVE TO DEVELOP LEGISLATION TO CHECK THE ABUSES ASSOCIATED WITH CORPORATE TAKEOVERS.

I WOULD LIKE TO SPEAK SPECIFICALLY ABOUT THE JUNK BOND PHENOMENON. LET ME EMPHASIZE THAT I AM NOT AN ECONOMIST OR A BUSINESSMAN, SO I DON'T PRETEND TO HAVE ANY SPECIAL EXPERTISE IN THIS AREA. BUT I HAVE BEEN FOLLOWING THE CORPORATE TAKEOVER CRAZE GENERALLY, AND THE JUNK BOND PHENOMENON SPECIFICALLY, FOR SOME TIME NOW, AND MANY ASPECTS OF THIS PHENOMENON GIVE ME PAUSE.

WHEN I FIRST BECAME CONCERNED ABOUT THE ROLE OF JUNK BONDS IN CORPORATE TAKEOVERS SEVERAL YEARS AGO, SOME SUGGESTED THAT I WAS AN ECONOMIC "CHICKEN LITTLE," BECAUSE I EXPRESSED CONCERN ABOUT THE DEFAULT RATE OF JUNK BONDS AND THE TROUBLE THAT SAVINGS AND LOANS COULD GET INTO WITH JUNK BOND INVESTMENTS. WELL, I'M HERE TO TELL YOU THAT THE SKY HAS FALLEN AND I THINK IT WILL FALL FURTHER. JUNK BOND DEFAULTS ARE UP DRAMATICALLY - THERE WERE OVER $3 BILLION WORTH OF JUNK BOND DEFAULTS LAST YEAR - AND WILL

CONTINUE TO INCREASE. WE HAVE SEEN ONE SAVINGS AND LOAN LOSE $10 MILLION IN THE JUNK BOND MARKET.

LET ME STRESS AT THIS POINT THAT I DON'T BELIEVE THAT ALL JUNK BONDS ARE BAD. I WOULD NOT SUGGEST THAT WE PROHIBIT ALL JUNK BONDS. IF INDIVIDUAL INVESTORS WHO KNOW THE RISKS WANT TO INVEST IN JUNK BONDS, THAT IS THEIR BUSINESS. WHAT I AM CONCERNED ABOUT IS THE OWNERSHIP OF JUNK BONDS BY BANKS, THRIFTS, AND PENSION FUNDS THAT ARE INSURED BY FEDERAL AGENCIES, SUCH AS FDIC, FSLIC, AND THE PENSION BENEFIT GUARANTY CORPORATION. IT WORRIES ME THAT DEPOSITORS AND BENEFICIARIES OF THOSE ENTITIES AND THE FEDERAL GOVERNMENT ARE INSURING SUCH RISKY INVESTMENTS. I SUGGEST THAT REASONABLE LIMITATIONS BE PLACED ON JUNK BOND INVESTMENT BY BANKS, THRIFTS, AND PENSION FUNDS THAT BENEFIT FROM FEDERAL INSURANCE GUARANTEES.

I WILL LEAVE IT TO OTHERS TO DISCUSS TAKEOVERS GENERALLY, THEIR EFFECT ON OUR ECONOMY AND THEIR IMPACT ON OUR FINANCIAL MARKETS. SUFFICE IT TO SAY THAT I AM CONCERNED ABOUT THE COST TO SOCIETY AS A WHOLE OF ALL THIS TAKEOVER ACTIVITY. TAKEOVERS INCREASE CORPORATE DEBT TO DANGEROUS LEVELS, DRAIN CREDIT RESOURCES FROM PRODUCTIVE USES, DECREASE THE COMPETITIVENESS OF OUR NATION'S CORPORATIONS, CAUSE RESEARCH AND DEVELOPMENT AND LONG-RANGE PLANNING TO BE SACRIFICED IN ORDER TO PAY OFF DEBT, ABSORB AN INORDINATE AMOUNT OF THE ENERGIES OF CORPORATE AMERICA, AND LEAD TO COMMUNITY DISRUPTION AND HUMAN DISLOCATION, IN THE FORM OF EMPLOYEE LAYOFFS AND PLANT CLOSINGS. THESE DEVELOPMENTS

LAST YEAR, THE FEDERAL RESERVE TOOK A SMALL STEP TOWARD CURBING ONE OF THE MOST ABUSIVE TACTICS IN CORPORATE TAKEOVERS, THAT IS THE USE OF JUNK BONDS TO FINANCE THE TAKEOVER. THE FED ISSUED AN INTERPRETATION OF REGULATION G OF THE MARGIN RULES THAT SUBJECTED JUNK BOND-FINANCED TAKEOVERS WHICH ARE CONDUCTED THROUGH SHELL CORPORATIONS WITH NO ASSET BASE OF THEIR OWN TO THE MARGIN REQUIREMENTS. THIS RULING WAS MADE BECAUSE THESE SHELL CORPORATIONS HAVE NO ASSETS WITH WHICH TO SECURE THE LOAN EXCEPT THE STOCK OF THE TARGET COMPANY. THEREFORE, THE FED DETERMINED THAT THE JUNK BONDS WERE LOANS INDIRECTLY SECURED BY MARGIN STOCK AND SUBJECT TO THE MARGIN REQUIREMENT.

THIS RULING, HOWEVER, HAS NOT LED TO A DROP IN THE AMOUNT OF JUNK BOND USED TO FINANCE TAKEOVERS. RATHER, THE CORPORATE RAIDERS HAVE SIMPLY CHANGED THE WAY JUNK BONDS ARE USED TO FINANCE TAKEOVERS. MORE JUNK BONDS ARE BEING ISSUED BY THE ACQUIRING COMPANIES THEMSELVES, RATHER THAN SHELL CORPORATIONS, TO FACILITATE TAKEOVERS AND CIRCUMVENT THE FED'S RULING. THUS, THE ABUSIVE TACTIC OF USING JUNK BONDS TO FINANCE TAKEOVERS CONTINUES.

I AM ALSO CONCERNED ABOUT THE JUNK BOND PHENOMENON BECAUSE IT PRESENTS A PARTICULAR DANGER TO THE INTEGRITY OF OUR CAPITAL MARKETS AND THE SAFETY AND SOUNDNESS OF OUR FINANCIAL INSTITUTIONS AND PENSION FUNDS.

A NUMBER OF FEDERALLY INSURED SAVINGS AND LOANS, PRIMARILY STATE-CHARTERED SAVINGS AND LOANS, HAVE INVESTED IN JUNK BONDS. IN MARCH 1985, THE FEDERAL HOME LOAN BANK BOARD CONDUCTED A STUDY

AND FOUND THAT FSLIC-INSURED INSTITUTIONS AND THEIR SUBSIDIARIES HELD $5.1 BILLION WORTH OF JUNK BONDS. AT THE END OF LAST YEAR, IT WAS ESTIMATED THAT THEIR HOLDINGS HAD INCREASED TO $7.6 BILLION. ONE SAVINGS AND LOAN HAS $2.33 BILLION - 28% OF ITS ASSETS - IN JUNK BONDS.

I AGREE THAT A WELL-DIVERSIFIED, PROPERLY MANAGED PORTFOLIO OF JUNK BONDS CAN BE VERY PROFITABLE FOR THESE INSTITUTIONS. I CAN UNDERSTAND WHY THESE SAVINGS AND LOANS ARE ATTRACTED TO THE HIGH YIELDS OF JUNK BONDS. BUT TO EARN HIGH YIELDS, YOU MUST TAKE HIGH RISKS.

ALTHOUGH JUNK BONDS HAVE A HIGHER THAN AVERAGE RETURN RATE, THEY ALSO HAVE A HIGHER DEFAULT RATE. FROM JANUARY 1, 1980 THRU LAST AUGUST, THE TOTAL AVERAGE DEFAULT RATE OF JUNK BONDS STOOD AT 3.4%. THE DEFAULT RATE ON NEW ISSUE JUNK BONDS, THOSE BONDS ISSUED AS JUNK BONDS, IS APPROXIMATELY 11%.

THERE HAS BEEN OVER $5 BILLION WORTH OF JUNK BOND DEFAULTS SINCE 1980. THE DOLLAR VALUE OF JUNK BOND DEFAULTS SKYROCKETED IN 1986 AND EXCEEDED $3 BILLION FOR THE FIRST TIME EVER. THERE WERE AT LEAST 28 JUNK BOND DEFAULTS IN 1986.

THE BEVERLY HILLS SAVINGS AND LOAN SUFFERED $10 MILLION IN LOSSES FROM ITS INVESTMENT IN JUNK BONDS. BEVERLY HILLS INVESTED IN JUNK BONDS AFTER INCURRING HUGE LOSSES IN THE REAL ESTATE MARKET AS A "LAST DITCH" ATTEMPT TO RAISE INCOME - AND THEN LOST $10 MILLION. THIS IS THE DANGER OF JUNK BONDS FOR UNSTABLE

INSTITUTIONS: THEY WILL BE ATTRACTED TO THEIR HIGH YIELD AS A WAY OF BAILING OUT OF THEIR FINANCIAL DIFFICULTIES.

IT IS BECAUSE THE DANGER OF DEFAULT IS ALWAYS PRESENT WITH JUNK BONDS THAT I ENCOURAGE THIS COMMITTEE TO TAKE THE STEPS NECESSARY TO ENSURE THAT NEITHER THE INNOCENT DEPOSITORS AT OUR NATION'S FINANCIAL INSTITUTIONS, THE INNOCENT BENEFICIARIES OF PENSION FUNDS, NOR THE NATION'S TAXPAYERS END UP PICKING UP THE BILL FOR A JUNK BOND DEFAULT.

CURRENTLY, NATIONAL BANKS MAY INVEST AN AMOUNT NOT IN EXCESS OF 5 PERCENT OF THE BANK'S CAPITAL AND SURPLUS IN JUNK BONDS, SO LONG AS THE EXERCISE OF PRUDENT BANKING JUDGMENT IS USED TO DETERMINE THAT THE ISSUER OF THE JUNK BONDS WILL BE ABLE TO MEET ITS OBLIGATIONS.

FEDERAL THRIFTS MAY INVEST UP TO 10% OF THEIR ASSETS IN JUNK BONDS IF THEY CLASSIFY THEM AS COMMERCIAL LOANS. OTHERWISE, THEY MAY ACQUIRE JUNK BONDS IN AN AMOUNT UP TO ONE PERCENT OF ITS ASSETS IF, IN THE EXERCISE OF PRUDENT BUSINESS JUDGEMENT, THERE IS ADEQUATE EVIDENCE THAT THE ISSUER WILL BE ABLE TO MEET ITS OBLIGATIONS, INCLUDING DEBT SERVICING.

HOWEVER, THESE RESTRICTIONS DO NOT APPLY TO ALL FEDERALLY INSURED INSTITUTIONS. ONLY THOSE INSTITUTIONS THAT ARE CHARTERED BY THE FEDERAL GOVERNMENT ARE SUBJECT TO THESE LIMITATIONS. STATE-CHARTERED BANKS AND THRIFTS ARE NOT SUBJECT TO THESE RESTRICTIONS. THESE INSTITUTIONS CAN INVEST IN JUNK BONDS WITHOUT

ANY RESTRICTIONS IMPOSED BY THE FEDERAL GOVERNMENT, EVEN THOUGH THE FEDERAL GOVERNMENT INSURES THESE INSTITUTIONS. FDIC AND FSLIC WOULD BE CALLED ON TO BAIL OUT INSTITUTIONS THAT GET INTO TROUBLE BECAUSE OF JUNK BOND HOLDINGS. IT IS UNFAIR THAT THESE FUNDS SHOULD BE CALLED ON TO INSURE SUCH RANK SPECULATION. IF THE RESTRICTIONS ON FEDERALLY CHARTERED INSTITUTIONS MAKE SENSE, AND I THINK THEY DO, THEN STATE-CHARTERED INSTITUTIONS THAT BENEFIT FROM THE FDIC AND FSLIC GUARANTEES SHOULD BE SUBJECT TO THE SAME LIMITATIONS.

ADDITIONALLY, AT THIS TIME, THERE ARE NO LIMITATIONS ON WHICH INSTITUTIONS CAN OWN JUNK. ONLY INSTITUTIONS THAT MEET CERTAIN MINIMAL NET WORTH REQUIREMENTS SHOULD BE PERMITTED TO DO SO.

AFTER THE JULY 4th RECESS, I WILL INTRODUCE THE JUNK BOND LIMITATION ACT OF 1987.

THE JUNK BOND LIMITATION ACT OF 1987 WOULD:

1. SUBJECT ALL FEDERALLY INSURED BANKS AND THRIFTS TO THE SAME LIMITATIONS ON JUNK BOND INVESTMENT THAT NOW APPLY TO NATIONALLY CHARTERED BANKS AND THRIFTS;

2. ALLOW FDIC AND FHLBB TO WAIVE THESE LIMITATIONS IF AN INSTITUTION DEMONSTRATES THAT THE INVESTMENT IN JUNK BONDS WOULD BE CONSISTENT WITH THE EXERCISE OF PRUDENT BANKING OR BUSINESS JUDGMENT;

3. PREVENT ALL FEDERALLY INSURED FINANCIAL INSTITUTIONS FROM INVESTING IN JUNK BONDS IF THEIR RATIO OF PRIMARY CAPITAL TO TOTAL ASSETS OR NET WORTH IS LESS THAN 6%;

4. AMEND ERISA TO LIMIT THE AMOUNT OF JUNK BONDS THAT A PENSION FUND CAN INVEST IN TO 10% OF THE FUND'S PORTFOLIO; AND

5. ENSURE THAT THE FEDERAL RESERVE'S MARGIN REQUIREMENT IS APPLIED TO JUNK BOND-FINANCED TAKEOVERS.

LET ME REITERATE: I UNDERSTAND THAT JUNK BONDS ARE A VITAL FINANCING TOOL FOR MANY COMPANIES. I AM NOT SUGGESTING THAT CONGRESS LIMIT THE ABILITY OF COMPANIES TO ISSUE JUNK BONDS OR TO RESTRICT THE ABILITY OF THE AVERAGE INVESTOR IN INVEST IN JUNK BONDS IF HE OR SHE WISHES. WHAT I AM SAYING I THAT THOSE INSTITUTIONS THAT BENEFIT FROM FEDERAL INSURANCE GUARANTEES SHOULD BE SUBJECT TO THE REASONABLE LIMITATIONS ON INVESTMENT IN JUNK BONDS. THESE RESTRICTIONS SHOULD BE UNIFORMLY APPLIED.

MR. CHAIRMAN, ONCE AGAIN I COMMEND YOU FOR TAKING THE STEPS TO END THE ABUSES OF THE CORPORATE TAKEOVER CRAZE. THE ACTIONS THAT YOU ARE CONTEMPLATING WILL PROTECT THE SHAREHOLDERS, THE EMPLOYEES, THE COMMUNITIES, AND THE GENERAL PUBLIC IN THIS COUNTRY. I HOPE THAT THE BILL THAT YOU REPORT TO THE SENATE WILL INCLUDE PROVISIONS RESTRICTING JUNK BOND INVESTMENT BY INSTITUTIONS INSURED BY THE FEDERAL GOVERNMENT.

THANK YOU.

The CHAIRMAN. Well, thank you very, very much, Senator Domenici. This is a very important recommendation you make and as chairman of the committee I welcome it. We will certainly give it every consideration. Thank you, sir.

Senator DOMENICI. Thank you very much, Mr. Chairman.

Senator HECHT. Mr. Chairman, is there going to be any opposing viewpoints on the distinguished Senator from New Mexico allowed?

The CHAIRMAN. I'm sure they will be.

Senator HECHT. But not today, right?

The CHAIRMAN. Well, there will be. We have a number of witnesses to testify and I think we should move on with the hearings, if the Senator would permit us to do that. But there's no question there's going to be a lot of give and take and hot and heavy discussion on this, both in the committee and on the floor. I'm inclined to support the Senator from New Mexico, but I'm sure there are other members, such as the Senator from Nevada, who have a different view.

Senator HECHT. Well, I would certainly feel that I am diametrically opposed to the distinguished Senator from New Mexico. I spoke on the Senate floor about it and just very shortly I will say that there are tens of thousands of jobs in his own State which I have listed in the Congressional Record that would not be there if it were not for high yield bonds or junk bonds, as they are affectionately called in this committee, and I've yet to see one savings and loan that has failed because of high yield bonds, but I do know of many savings and loans that have failed because of energy loans and real estate loans.

At an appropriate time, I will further my speech.

The CHAIRMAN. Thank you, Senator Hecht.

Senator DOMENICI. Thank you very much, Mr. Chairman.

I might say to my friend from Nevada, the Senator from New Mexico is fully aware that there are billions of dollars of junk bonds that have entered the American marketplace, predominantly in the last 8 to 9 years, that have served a very good purpose for growth companies. I'm addressing only the issues of whether the Federal Government should be treating guaranteed institutions differently with reference to junk bonds and whether the Federal Government should, in some mild way, minimize the use of junk bonds in corporate takeovers. Those are the only two issues that I addressed in my bill that I will send to you very shortly and in my discussion with this committee.

The CHAIRMAN. Thank you very, very much.

Senator ARMSTRONG. Mr. Chairman, before we let the Senator from New Mexico depart, I just want to be sure that we are including in this category of junk bonds those high yield instruments which are not backed by any substantial collateral that I assume he's referring to government bonds, as well. [Laughter.]

Senator DOMENICI. Well, I would be delighted to discuss the subject.

Senator ARMSTRONG. I thought it might strike a nerve.

Senator DOMENICI. It might make everyone here feel very uncomfortable. We might very well find out whether they are junk or not within the next 2 months.

Senator ARMSTRONG. Thank you.

Proposed Solution:

- Adoption of the following provision of the Securities Exchange Act:

(a) Congress declares that the continued regulation by the several States of matters involving the internal affairs or governance of corporations organized under the respective laws of such States is in the public interest. The internal affairs or governance of corporations shall be subject to regulation by the laws of the State under which each such corporation is organized.

(b) Nothing contained in Sections 13 or 14(d) or (e) of this Act or any rules or regulations thereunder shall be construed to invalidate, impair or supersede any law enacted by any State regulating the internal affairs or governance of any corporation organized under its laws, notwithstanding any effect thereof upon any person's ability to cause a change of control of such corporation by means of a tender offer.

(c) Notwithstanding subsections (a) or (b) hereof, this section does not authorize any State to enact any law which would preclude compliance with the filing, disclosure or other procedural requirements, or the anti-fraud requirements, of Sections 13, 14(d) or 14(e) of this Act.

(d) For purposes of this section, the internal affairs or governance of a corporation shall include, but not be limited to, matters relating to the voting rights of securityholders, mergers and other business combinations and the approval thereof, the rights and obligations of controlling or other significant shareholders, and other matters relating to the control, management or government of such corporations or to the relative rights and obligations of, and between and among, securityholders, directors, officers and their corporations.

[Congress has the power to authorize the States to legislate in a manner that would otherwise violate the Commerce Clause or the Supremacy Clause. This provision is intended to have that effect, thereby changing the judicial analysis of State statutes which regulate corporate internal affairs or governance but which also affect certain contests for corporate control. The proposal would not, however, rejuvenate State statutes directly regulating tender offers.

Moreover, even a statute which regulates corporate governance matters would not be authorized if it would preclude compliance with the Williams Act, as embodied in Sections 13, 14(d) or 14(e) of the Securities Exchange Act. Note that the proposal would have no effect on the current one share/one vote controversy, which turns on stock exchange listing requirements rather than on the constitutionality of any State statute.]

The CHAIRMAN. Mr. Clark, that's a tough act to follow.

STATEMENT OF DONALD C. CLARK, REPRESENTING STAKEHOLDERS IN AMERICA

Mr. CLARK. Thank you, Mr. Chairman.

On March 4, I was privileged to appear before this committee to present a few suggestions concerning tender offers and the need for legislation. Today, I am privileged to appear again, but now on behalf of Stakeholders in America. Stakeholders in America is a coalition to counter the abuses of hostile takeovers. Not to prohibit them, but just to counter the abuses.

The content of S. 1323 to me testifies eloquently that this committee listened carefully to both sides of the issue and crafted a bill which, if adopted, will substantially level the playing field for tender offers. I therefore would like to offer my compliments to you and your staff for a balanced product.

RECOMMENDATIONS

Several of the suggestions that I and my colleagues made back in March were not adopted, so I would like to respectfully resubmit some of them for your reconsideration at this time. I believe that their adoption would still leave us with a balanced approach toward hostile takeovers.

The first suggestion is that the tender offer period should be extended to at least 60 days, not 35 business days, although certainly 35 days is a substantial improvement over the current 20-day period.

A board of directors truly needs a lot of time to maximize shareholder value by seeking out a full range of alternatives to a raider's hostile bid, including the possible need for a shareholder meeting.

Some free market economists simply point to the fact of a premium as the beginning and the end of the analysis as to whether or not shareholders are better off. I personally believe that the board of directors has a legal obligation to maximize shareholder value and, therefore, we must look beyond the fact that there is a 30-percent or a 40-percent premium.

The *Trans-Union* decision in the Delaware courts has reemphasized that principle. Therefore, time becomes a critical element in helping the board discharge this important responsibility. I believe a board needs considerable time to take a look at all options, including self-liquidation, full auction of the company, et cetera.

I also believe that more time would permit other constituencies an opportunity to express their concern about the takeover of a company.

No. 2 concerns front-end loaded, two-tier, and partial tender offers and I suggest that they should be prohibited. All tender offers are inherently coercive, but the most coercive of all are the front-end loaded, two-tier and partial variety.

Shareholders need to be protected from the forced pressure of having to make a quick but uninformed decision.

Defensive tactics adopted by management have been criticized by some, but they have been a needed response to what up to now has been a one-sided game.

Stakeholders in America has suggested seven legislative provisions which would cure many of the abuses of unsolicited hostile takeovers. Only one suggestion has not been discussed in my testimony or is not already contained in the bill. Therefore, I also recommend the committee consider the following.

There should be a requirement for increased disclosure of the economic effects of a bidder's proposal similar to those required in registration statements, including effects on employees, communities, creditors, pension funds, and governmental units.

Boards of directors truly need this information so they can properly develop their recommendations to the shareholders. It would also give needed information to other constituency groups, including labor, allowing them to voice a more informed opinion.

In supporting S. 1323 and I do so because I believe it is a fair bill, I am especially pleased by section 36, which provides in part "The Congress declares that the internal affairs or governance of corporations shall be subject to regulation by the laws of the State under which such corporation is organized."

However, in my written testimony I strongly argue that section 8 of the bill, Action By Issuers, should be deleted. That section deals with restrictions on the payment of greenmail and during a tender offer period the granting of so-called golden parachutes and the issuance of so-called poison pills.

I am not here to testify for or against those defense techniques, although I personally disagree with the practice of paying greenmail. I oppose section 8 because it directly conflicts with the principles enunciated by section 36. Section 8 clearly deals with the internal affairs or governance of corporations and therefore deals with a subject matter that, continuing with the language of section 36, should be "subject to regulation by the laws of the State in which the corporation is organized."

In summary, as I view S. 1323, I believe it to be a very fair bill. It goes a long way toward correcting some of today's most abusive tactics, yet it still leaves a workable set of rules for the takeover process while ensuring that all shareholders are treated fairly and each will be given full and timely disclosure of important information.

Thank you.

[The complete prepared statement of Donald C. Clark follows:]

The CHAIRMAN. Well, thank you very much. We thank all of you gentlemen. These are three of the best statements we've had on this issue.

DELETE GREENMAIL, GOLDEN PARACHUTES, AND POISON PILL PROVISION

Mr. Clark, on one of the last points you made, you would have us knock out our prohibition of greenmail and eliminate the golden parachute and poison pill prohibition we have after a takeover commences.

That, of course, would cause many people to say that we had a very unbalanced bill. You say, however, that perhaps the States can govern those defenses.

That's a good argument because I think we should leave as much as we can to the States. At the same time, it seems to me that from a practical standpoint we've come about as far as we can to get a balanced bill.

Mr. CLARK. Senator, I, too, am a practical man. If it's required for the passage of your bill, I would keep it in. But I did want to point out, in my opinion, it is in conflict with the very important position taken by this committee in section 36 that State law should govern the matter. Those out there who are concerned about abuses by corporate management, boards of directors, can and should look to the State courts for their remedies. The State courts will not sit idly by and permit boards of directors to abuse the shareholders and I think that is the safeguard. Therefore, my emphasis truly is on States' rights.

Mr. ATWATER. Might I comment on that same question, Senator?

The CHAIRMAN. Absolutely.

Mr. ATWATER. I think greenmail is an absolutely appalling practice, but it is essentially cured, as are the problems of poison pills, if a 100-percent tender offer is made for the company. At that point, greenmail is not an issue and neither are shareholder rights.

What we are really talking about here is some place between 5 and 10 percent of all the takeovers that are made in the United States which are partial. It is only these partial takeovers which essentially trigger the provisions that we're talking about. In other words, greenmail and shareholder rights plans are a symptom of what is wrong.

The CHAIRMAN. They're the symptoms, but they are the very essence of unfairness because what happens with greenmail, is that a raider as a shareholder is paid off at a higher price than the other shareholders are.

Mr. ATWATER. Absolutely.

The CHAIRMAN. That's just plain wrong. It is one of the things we want to correct. Shareholders should be treated equally and fairly.

Mr. ATWATER. And the way to do that, Senator, if I could suggest, is to have a tender for all of the shares. Then everybody is treated equally and greenmail will never be an issue.

The CHAIRMAN. I think you're right about that. That's the principle we would like to follow.

Mr. Trowbridge, you suggested that if a group indicates their intention to take over a corporation, then you say that if they sell, having driven the price of the stock up, that any profits they make should recur to the issuing corporation if they sell within 6 months.

I began with a much stronger provision originally. If they got above a certain level of stock ownership they would have to share any profits they make over a period of 5 years and they wouldn't be able to sell within 4 or 5 years without sharing that profit.

Mr. **Trowbridge**. Senator, I think our objectives are clearly the same. It seems to me that the 5-year period may be a bit long. If we can establish the principle that a raider seeking a quick profit does so with the knowledge that he would have to share that profit back with the target, then it would certainly be a point of discouragement.

The **Chairman**. So many of these problems have been caused by people who have no intention of taking over the corporation. Some of the most prominent raiders have made hundreds of millions of dollars literally and have never taken over a major corporation. Again and again and again, they bid and are very successful in driving the price of the stock up and they are able to sell out at a high profit. They impose an enormous burden of debt on the corporation. They cause many enormous disturbances in unemployment; the community loses business and so forth. Raiders lose but they laugh all the way to the bank.

Mr. **Clark**. It's been pointed out before but I would like to reemphasize that the management must disgorge any profits on a buy and sell transaction within a 6-month period without any indication that inside information was used in the trade.

The **Chairman**. That's very helpful.

All of you gentlemen made fine statements, but I want to commend you, Mr. Atwater, on what I think is especially outstanding testimony.

Now there are sections of securities law that do provide for remedies against market manipulators, presumably including manipulative raiders. Sections 10(b), 14(e), and 15(c) all make reference to manipulation.

Why are these sections inadequate to stop the raider who simply wants to put a company into play by shouting "takeover" and then selling his stakehold. In every raid there are always lawsuits. Why doesn't litigation ever uncover fraud and send raiders to jail? Why is the present law so ineffective?

INEFFECTIVENESS OF PRESENT LAW

Mr. **Atwater**. I think the real problem is in how do you detect what I showed in step one of how these manipulations take place. In other words, when there are telephonic conversations between a coordinator who is generally an investment bank and two or three arbs and an investment manager and a raider, what they're saying is Dayton Hudson is likely to have an offer made for them. That is, per se, illegal under today's rule. But with the 5-percent limitation and the 10-day business, as long as they stay under 5 percent, it's darned near impossible to detect them.

So what your bill does by lowering that to 3 percent and then making an affirmative requirement that they disclose communication between them and then putting a sufficient penalty on it, you begin to get at what is really undetectible right now, and that's the biggest problem that we've got. These guys can start the game and never get caught, and when they do get caught, as you say, they make $50, $70, $100 million and the penalty is about $5,000. The risk-reward is just plain not in balance.

So everything you're doing in your bill gets right at that except you need to add investment managers to the disclosure. In your bill or currently, investment managers are not covered.

The CHAIRMAN. Mr. Clark.

Mr. CLARK. Senator, I've always been impressed in a negative way with the fact that the disclosures of all of the major abuses that have taken place in insider trading have resulted not from the uncovering of these transactions because of current rules, but this all started as a result of an anonymous tip against one individual, who then started to tell the story.

That, itself, indicates to me a great need for more disclosure requirements. As Mr. Atwater said, disclosure is the most important tool that we have to benefit shareholders to let them know what is going on. All of the legal action that has been taken against the Boeskys, et cetera, all came from one anonymous tip, not from present disclosure requirements.

The CHAIRMAN. That's a very helpful observation. I couldn't agree with you more and I think at the heart of our bill is the promotion of disclosure.

Mr. ATWATER. I was only going to say that some people make an argument that the 5 percent is very important because the raider needs to be able to accumulate that much secretly to pay his fees to his lawyers and his investment banks.

Now the question is, who is paying those fees? And it's the little old lady in tennis shoes who doesn't know enough and sells to the raider that is giving him his profit. So that argument is not a very good argument and it has been made by people at the SEC.

The CHAIRMAN. Senator Bond.

Senator BOND. Gentlemen, I apologize for not having been here when you actually testified. There was another committee hearing I had to attend. I appreciate the views you've given and will have an opportunity to review in more detail the statements you presented.

I was interested in that diagram that you have there, Mr. Atwater. If you are suggesting by that diagram that the five groups in yellow are acting in concert, is not perhaps the best approach for dealing with them to try to make it clear when acting in concert whether the shares of the different players should be considered as part of a control group? Isn't that one approach to answering that question?

Mr. ATWATER. Yes. That would be very helpful, Senator, but it still wouldn't get at the extreme difficulty of detecting a relationship between these people. And the way you do that is just very simply to lower the disclosure amount so they have to file at that point.

There is really very little burden in disclosing at that level because everybody has their records electronically set up anyway and they can be very easily submitted electronically. So the burden argument doesn't apply.

And really, historically, from the 1933 and 1934 securities act enactment, disclosure has been what has been the disinfectant to the system.

So I completely agree with you on the definitional side of it, but I think we need to lower the amount so you can really detect what's going on.

Senator BOND. One of the greatest benefits that our country has is the capital markets and the fact that capital markets operate freely and are able to put capital into productive enterprises in which everyone takes a risk.

Do you see a danger in any of the proposals before this committee of interfering with that free flow of capital?

Mr. ATWATER. No. I think just the reverse. I think the proposals in the current bill will enhance the capital markets. Capital markets work best when people trust them and when there is no manipulation going forward. Ninety-five percent of all the takeovers that are done in this country anyway in the dollar value are 100 percent takeovers, and most of the testimony you've heard in the last several days have been people who are trying to protect partial, front-end loaded type takeovers. So I don't believe this will in any way harm the liquidity of the markets and, if anything, it will enhance people's faith in it, which has been badly shaken by the scandals on Wall Street currently and, I should add, by the high salaries that are being drawn down by these Wall Street figures from this kind of activity.

Senator BOND. Now, Mr. Atwater, you're doing all right, aren't you, sir, in terms of salary?

Mr. ATWATER. Proportionately, I think the average compensation of the top ten Wall Street figures was $50 million a year and the highest paid guy was $125 million, and corporate remuneration pales in comparison to that.

Senator BOND. We will point out, as we have in prior hearings, that legislative pay pales in comparison with your salaries, so we are somewhat underwhelmed by that argument. [Laughter.]

Mr. Trowbridge, you had a comment.

Mr. TROWBRIDGE. Senator, just to add to what Mr. Atwater mentioned on the importance of disclosure and particularly the importance of making good on the declaration of intent when making a purchase "for investment purposes." Our recommendation is to support the requirement that that declaration be held applicable for a 6-month period, that a person who buys in and says, "I'm doing it for the purpose of investment," has got to hold on for 6 months to the shares acquired.

I think that would help disclosure purposes. It would make honest people out of some who like to use these words but never get challenged on them.

Senator BOND. By the same token, it would also impinge upon the person who had taken it as an honest investment and within that 6-month period became a white knight and came to the rescue of the management that would be protected, is that not correct?

Let me ask one other question. Several of the witnesses that we had yesterday suggested that the best thing that we could do with poison pills, greenmail and all of the other things that I think generally are abhorrent is to have stockholder approval of poison pills and any measure that would affect the free transferability of control.

Mr. Chairman, could I ask your indulgence to allow them to answer that question?

The **Chairman**. Sure.

Senator **Bond**. I'd appreciate comments from each of the three of you on that.

STOCKHOLDER APPROVAL

Mr. **Clark**. I think the creation of all of the defensive tactics have been a result of the uneven set of rules that we currently deal with. I personally—and I can't speak for anyone else—but I would be happy to give up many of the defensive tactics that we have adopted if we had a level playing field.

I think it's been a reaction on management's part, but it's been a forced reaction to a set of circumstances and the abuses have just been rampant.

Senator **Bond**. But if they are abuses, what's wrong with giving the shareholders the right to approve any?

Mr. **Clark**. I have no difficulty if once we get a level playing field, but——

Senator **Bond**. Making it a level playing field, giving the shareholders the right?

Mr. **Clark**. Fine. Absolutely. I would endorse that. But I would point something out that is troublesome to me, yet I don't have a solution for it.

The chairman of Dayton Hudson has just indicated that in the last 3-week period 35 percent of his shares have changed hands. These are 35 percent that he can identify. Now I believe that that company is in serious difficulty in going to the shareholders for a support vote. You can just automatically start out—he's got 35 percent against him that he knows of and, therefore, it's an uphill battle.

That's the dilemma that I see and I have no solution for it, other than management is subject to review by the State courts and they will be held accountable. Some decisions must be made by management and there is a conflict in trying to balance the needs and the rights of the shareholders against the other constituency groups of a corporation and it's a difficult job for management. But the State courts are the ones that should come up with the remedies.

Senator **Bond**. Any other comments on that?

Mr. **Trowbridge**. Merely to echo that point, Senator. The process we are looking at here hopefully is the reform of the Williams Act and the improvement of the disclosure process at the Federal level, with the business judgment elements hopefully retained at the State level where corporations have their incorporation papers. They live by the rules of the road when they start and when they operate within that State.

Mr. **Atwater**. Senator, let me take a little different tack on this. In talking about both greenmail and shareholder rights or poison pills, these are all designed in defense of partial offers. If a 100-per-

DONALD C. CLARK
Chairman and Chief Executive Officer
Household International
Testimony Before

UNITED STATES SENATE COMMITTEE
ON
BANKING, HOUSING, AND URBAN AFFAIRS

June 25, 1987

On March 4, 1987, I, as Chairman and Chief Executive Officer of Household International, was privileged to appear before this Committee to present a few suggestions concerning tender offers and the need for legislation. Today I am privileged to appear before this Committee on behalf of Stakeholders in America to comment on the Tender Offer Disclosure and Fairness Act of 1987, introduced by Senator Proxmire on June 4, 1987. Stakeholders in America is a coalition to counter the abuses of hostile takeovers.

The content of the Bill testifies eloquently that this Committee listened carefully to all of the witnesses that appeared before you. Your Staff has crafted a Bill which, if adopted, will level the playing field for tender offers. I would like to offer my compliments to you and your Staff for a truly professional product.

Several of the suggestions I and my colleagues made on March 4, 1987, were not adopted, and I do respectfully resubmit some of them for your consideration.

1. The tender offer period should be extended to at least 90, not 35 days. A Board of Directors needs time to maximize shareholder value by seeking out a full range of alternatives to a raider's hostile bid. In some cases it may be appropriate to call a special shareholders' meeting. 35 days simply does not provide adequate time for a Board of Directors to fulfill its fiduciary duties.

2. Front-end loaded, two-tier and partial tender offers should be prohibited. All tender offers are inherently coercive, but the most coercive are the front-end loaded, two-tier and partial variety. A favorite argument of those who believe in the so-called efficient market hypothesis is that "Decisions regarding the purchase and sale of corporate stock should be governed by one factor and one factor alone--the price at which a willing seller will sell to a willing buyer."[1] The problem with that notion in today's uneven playing field is that the two-tier and partial offers are so coercive that when utilized by a raider the seller becomes, not a willing participant in the transaction, but a person forced to sell his stock to avoid receiving a lesser sum later or, worse, receiving a lesser value evidenced by the raider's questionable paper. These coercive practices must be prohibited.

Stakeholders in American has suggested seven legislative provisions which would cure the abuses of unsolicited takeovers. Only the following suggestion has not been discussed in my testimony or is not already contained in the Bill. There should be a requirement for increased disclosure of the economic effects of a bidder's proposal, similar to those required in registration statements, including effects on employees, communities, creditors, pension funds, and governmental units.

In supporting the Bill, and I do so enthusiastically, I am especially pleased by Section 36, which provides, in part:

> "The Congress declares that the internal affairs or governance of corporations shall be subject to regulation by the laws of the state under which such corporation is organized."

Section 36 correctly reflects the teachings of Santa Fe Industries v. Green[2] that substantive corporation law is to be controlled by state law and not federal law. The United States Supreme Court in the CTS case recently reaffirmed the primacy of state law in the area of corporate governance.[3]

Prevailing state corporation law provides that it is the responsibility of a board of directors, not that of a corporation's shareholders, and, I respectfully submit, not that of the Congress of the United States, to direct the management of the business and affairs of a business corporation.[4] Directors alone have the right and duty to make decisions on significant corporate policies involving evaluation, assumption or avoidance of risk. I should also add that it is those same directors who bear the risk of personal liability.

Section 36 of the Bill, therefore, strongly dictates that Section 8 of the Bill, "Actions By Issuers", should be deleted. Section 8 declares as unlawful or prohibits greenmail, and golden parachutes and poison pills adopted during a tender offer. I hasten to state that while I am personally opposed to the payment of greenmail, I am not here to testify for or against any of those defensive techniques. I am here to testify that Section 8 clearly deals with the "internal affairs or governance of corporations" and, therefore, deals with subject matter that, according to the language of Section 36, should be "subject to regulation by the laws of the state of which such corporation is organized."

Should Section 8 be adopted, the Congress would be preempting the role of boards of directors, a role the courts have prudently and correctly avoided. That is what the well-known business judgment rule is all about---a tool of judicial review---"a presumption that in making a business decision the directors. . . acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[5] Congress cannot now know what threats or newly devised takeover/bust-up techniques will be faced by tomorrow's board of directors. If I have learned anything about the corporate raider, it is that he and his advisors are highly imaginative, inventive, and aggressive. They have come up with the front-end loaded, two-tier and partial tender offer, the street sweeping maneuver, and the use of junk bonds, among other well-known techniques. I am very confident that tomorrow's boards will be faced with even more imaginative and highly effective takeover/bust-up techniques.

The Wall Street Journal in an June 15, 1987 article entitled, "British Firms Step up Takeover Action In The U.S." reported that:

> "The British are coming--on a shopping spree for U.S. corporations, with bigger bucks and bolder financing than ever before . . .

> "Entrepreneur executives here (the U.K.) have long hungered for transatlantic acquisitions as a way to expand in the vast and vital American market . . .
>
> "The trend toward more and bigger U.S. takeovers doesn't seem likely to abate."

I recognize that Section 8 prohibits golden parachutes and poison pills only if adopted *during* a tender offer. I do not find this limitation on the Bill's prohibitions particularly helpful since the very existence of such prohibitions could be construed, and will certainly be argued by raiders, as a legislative finding that such techniques are not in the public interest or for the protection of investors. I have also observed that Section 8 empowers the Commission to provide exemptions from restrictions on greenmail and golden parachutes. The Commission would similarly be empowered to provide an exemption for poison pills "to the extent that such exemption is necessary or appropriate in the public interest and for the protection of investors and consistent with the purposes and policy fairly intended by this paragraph." I take little comfort from these powers being granted to the SEC. That Agency has many times expressed its views on the use of any defenses to tender offers. The SEC filed an amicus brief in the *Moran* v. *Household* case. That brief stated, in relevant part:

> "It is our view that the Household plan would deprive shareholders of an opportunity to consider virtually all hostile tender offers, would also have a significant deterrent effect on proxy contests against managment, would thereby entrench management against efforts to oust it, and thus is not in the shareholders' interests."[6]

Although subsequent events have proven the SEC wrong, I, have little doubt as to the use that the current SEC would make of the power granted to it to exempt management defensive techniques from the prohibitions contained in Section 8.

Because attitudes and the makeup of the SEC and its staff will change (a new chairman recently having been nominated), it seems inappropriate for Congress to grant authority to the SEC to effect substantive law. I therefore strongly urge the deletion from the proposed

Bill of Section 8 which is totally at variance with Section 36, is at odds with the teachings of the United States Supreme Court, and which, most importantly, would unfairly and imprudently tie the hands of U.S. boards of directors. If the Committee truly is concerned that U.S. boards of directors are entrenchment motivated (an oft used but seldom, if ever, proved canard), or that U.S. boards of directors will abuse their power, I believe the Committee can safely rely on the state courts to restrain any such breaches of fiduciary duty. I believe that is why Section 36 was included in the Bill.

Thank you for the privilege of appearing before you.

Footnotes

[1] June 11, 1987 testimony of Harold C. Simmons, Chairman of the Board of Vahli, Inc. before the Subcommittee on Telecommunications and Finance of the Committee on Energy and Commerce, U.S. House of Representatives.

[2] 430 *U.S.* 462 (1977).

[3] *CTS Corporation* v. *Dynamics Corporation of America*, 55 *U.S.W.L.* 4478 (April 21, 1987).

[4] *8 Del.C.* Section 141(a)-Section 8.01 *Rev. Model Bus.Corp. Act*

[5] *Aronson* v. *Lewis*, 473 *A.2d* 805 (Del. 84).

[6] 500 *A.2d* 1346 (Del. 1985)

cent offer for a company is made, obviously the shareholder rights all belong to the acquirer and greenmail is clearly not an issue because you own 100 percent of the shares.

Ninety-five percent of the dollar value of takeovers historically in the United States are for all of the shares. So these two devices go away as you legislate, as we are advocating, that acquisitions be for 100 percent of the shares. Operating acquisitions are for 100 percent of the shares. Manipulative acquisitions are for less. So the problem gets taken care of by itself.

The second point I would make on shareholder rights plans is that as they have actually worked out what they do is give the management time to shop for a better offer. I mean if you're in play and you're going to be gone, your obligation to your shareholders as directors and as management is to get the best offer you can. That extends the time of those offers.

So I think those two reasons strongly support our recommendation that once you get over a certain shareholding level that you have to go for all of the shares. That would basically solve 90 percent of the problems that you bring up.

Senator **Bond**. Thank you. Mr. Chairman, I appreciate your indulgence.

The **Chairman**. Senator Wirth.

Senator **Wirth**. Thank you, Mr. Chairman.

Gentlemen, thank you very much for being here and spending so much time in helping us sort through this difficult issue.

RELATIONSHIP BETWEEN FEDERAL AND STATE GOVERNMENTS

In the hearings so far I have tried to focus a little bit on a thorny issue that we face, a very political issue, and one that goes right to the heart of all of the governance issues, and that's the relationship between the Federal Government and the State government.

Mr. Atwater, I must say your statement is very good on that, providing that kind of history, and I really appreciate that. And it's pretty well summed, Mr. Trowbridge, in your summary in which the NAM's position you talk about your support of this while reaffirming the successful State role in corporate governance.

What we're faced with and you all are familiar with—we've been around this for years and years and years—is where the balance is between the Federal Government and the State government, and I needn't reiterate the various positions there of whether we have a national economy or whether we should allow States to move in and the Brandeis charge that States ought to be allowed to experiment and so on. You all are familiar with that.

What is interesting is what I think may be some inherent contradictions in what these pieces of legislation do, whether it's this bill or the bill on the House side, related to distinctions made between the regulation of bidders and the regulation of management.

We have for a long time—remember we're talking about a Federal-State issue and I'm going to try to split that down and get your comments on this if I can—between how we balance off the relationship between the Federal and State government in our jurisdictions as it affects bidders and as it affects management.

Effectively, what we're doing in this legislation on the bidders' side is to say what we're going to do is really squeeze down on bidders. There are three major provisions in this I think. One is the closing of the 13(d) window, the second is extending the minimum offering period, and the third is the focus on creeping tender offers. Those are I think the three major provisions in the legislation that really go to the question of controlling and more tightly regulating bidders.

So we've said we could do that through Federal law and the States can go beyond that if they want to. We've said that if the States want to go beyond what the Federal Government does in that area, fine, you can go ahead and do that, and then I guess that's what the Indiana decision in effect did.

On the management side, we have been very reluctant until the last couple of months—I think this is correct, and correct me if I'm wrong—I want to get your reaction to this. I'm trying to really understand all of this and make sure that we all understand it. On the management side, we have said we're not going to control what management does, we're not going to control management practices, we're going to leave that to the States.

But in effect we have in this bill started to move in on management practices. We have made reference to golden parachutes and to greenmail and poison pills and I can imagine a very, very long list—and I think it's bad policy for us to try to list all of these things in there because that's an invitation to lawyers to figure out all the items that aren't listed and then go ahead and do those and say they are legal because they are not included in the bill. I think we've all talked about that, too.

What we have done in this bill is to start to move in on management as well. We have really changed the pattern of assuming that the States were right in the area of corporate governance. There is a fundamental change that's in here.

Now is that the case or not, or is just this nibbling away by focusing on golden parachutes and focusing on greenmail and focusing on poison pills an aberration or is that not important or have we gone over a line in which the Federal Government is now getting into the regulation of management practices?

Do you see what I mean? Do you mind making the distinction? We have not talked about that, but I think it's a very important issue for us to address and there's a significant precedent in this. So I would really like your reactions. It's too long a question, but I'm a little confused by it and I think all of us are groping with this very delicate relationship.

Mr. ATWATER. Well, you're raising a very fundamental question and I will preface at least by saying I am not an attorney.

Senator WIRTH. I'm not, either.

Mr. ATWATER. Excellent.

Senator WIRTH. There are lots of them in here, though. Their clocks are ticking.

Mr. ATWATER. I'm associated with a number of them. As I understand the legislative history, the Federal Government has basically focused on the issue of disclosure and the issue of process in takeovers.

I think the current rhetoric which tries to lay a whole bunch of negatives on raiders and then balance it with a whole bunch of negatives on management perhaps is addressing the wrong issue.

I think the real issue is the process itself and is it fair to the shareholders, not is it fair to the raiders or is it fair to the management, but is it fair to the shareholders?

So the distinction that historically has been in the studying that I've done is that the 1933 and 1934 Securities Act had exactly this same argument, Senator. It's very interesting to go back and look between disclosure and fairness and substance. And Congress, in their wisdom, came down on the side of disclosure. It happened again in the 1960's and there's very interesting legislative history. Again, this argument between disclosure and substance. And every time the Federal role has basically been disclosure and process oriented and the States, which after all charter the corporations and they are creatures of the States, regulates the internal voting and governance.

And I think as you fuzz that, which you can if you keep the rhetoric of balancing management versus the raiders, you do tend to get into some trouble. That's why in my testimony we have stressed the process and disclosure and it's basically what your bill does, with the exception of the three things that you outlined, which frankly wouldn't be—those three things are perhaps politically necessary, and I can't really make a judgment on that, but they are not substantively necessary.

What you described as penalties to the raiders, if you very simply say any time you get over a certain percent you've got to go for all of the shares, all the rest of this goes away and that's procedural. That's frankly where I would focus.

Senator WIRTH. And how would you have us act on the management side looking at stepping over that line? Are we stepping over the line by getting into golden parachutes and greenmail issues or should we leave all of that out?

Mr. ATWATER. I don't think that is a fundamental part of this bill. I think if you add the any and all takeover provision, you don't need either one of those sets of negatives against raiders or managements.

Senator WIRTH. Mr. Trowbridge?

Mr. TROWBRIDGE. Senator, I, too, feel that the focus of this effort has to be consistently placed on the impact on the shareholder and what's the best disclosure and procedure that allows the shareholder to know that whatever the outcome there's maximum value for his or her interests.

I would agree with Mr. Atwater that if we require a 100-percent tender offer after reaching a certain amount level, then that almost automatically takes away the greenmail problem which usually comes with a partial takeover attempt. Regarding golden parachutes, if there is a provision which says that no golden parachutes should be incorporated by a company during a period of a tender offer, I think that we would probably be only confirming current practice. I think that's a perfectly legitimate expectation that management would not put such a plan in while a tender offer was in process because it would, again, change the potential shareholders' value.

So that if we do look at this as a battle between raiders and management, and who wins the ballgame, I think we are probably looking at the wrong teams. The team we ought to look at is the shareholders, and my feeling is that the disclosure requirements as outlined in S. 1323 would adequately do that and not require a great deal more either on the raiders' side or on the management side.

Mr. CLARK. I would agree with what has already been said, but I would just summarize by suggesting that you are, if you adopt section 8, encroaching in a States matter. I believe that firmly. I think the question that this committee has to ask itself is, is there really a need for it, or are not the State courts and the proxy procedures where the board is up for election for the most part every year—are they not the proper remedy for any abuses?

Mr. ATWATER. My associate reminds me that the legislative history that I quoted to you is actually from your report when you were in the House and it's from House documents.

Senator WIRTH. You're a great scholar, Mr. Atwater. [Laughter.]

Well, Mr. Chairman, I think what's happened in this bill is we've gone over the line already and effectively we have said we're going to regulate bidders and we did that before. That's been a purview of the States before. We went over that line by regulating bidders and now we're saying in part we're going to go over the line by regulating certain management defensive actions. So we're already there.

I think what we might want to do is to look at the statements made by Mr. Atwater and Mr. Trowbridge. Mr. Atwater said the fundamental question is, is it fair to shareholders; and Mr. Trowbridge said, what's the impact on shareholders. Maybe what we ought to be considering here is some way to assure that shareholders consistently have a voice or have a right of action or whatever it may be if they feel that they are abused. Maybe this is a fundamental part of what we're talking about and we don't have to try to pick out a whole lot of individual techniques like greenmail or golden parachutes or whatever they may be, but we just ought to consider the possibility of giving the shareholders some kind of a greater voice and that might be something that we might want to look at in terms of a piece of legislation to answer the questions that Mr. Atwater and Mr. Trowbridge are asking.

Mr. ATWATER. And actually shareholders do have a complete and very workable mechanism currently. Take the recent proxy season where I think well more than 50 companies had proxy issues that came in front of their shareholders on shareholder rights plans. Every one of them was upheld. But the point is, corporate democracy works. These came forward and were questioned and were in fact passed and endorsed. So the procedure already works. We don't need legislation in that regard.

Senator WIRTH. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Wirth. I think that's very helpful and we will certainly give that every consideration when we mark up the legislation.

Senator Riegle.

Senator RIEGLE. Thank you, Mr. Chairman.

I appreciate the endorsement that the NAM has given the legislation today and I think that's helpful to us.

Mr. Atwater, does your organization generally support this legislation?

Mr. ATWATER. Yes. Our organization does support this legislation. We think there are a few places where the legislation could go further, as I have outlined, Senator.

Senator RIEGLE. And how about you, Mr. Clark?

Mr. CLARK. Absolutely.

Senator RIEGLE. I think it's important that we have that on the record and that it be clearcut.

FLAWS IN LEGISLATION

Yesterday Mr. Greenhill was here representing Morgan Stanley, Goldman Sachs, and First Boston—the Capital Markets Group—and he testified that in their view there were a number of flaws with the legislation that we've introduced. Among the ones that they cited—they believe in Federal preemption. They think that that's a very important point that ought to be seen the other way. They believe there should be much tougher restrictions on corporate defenses and they spelled that out. And they also oppose the private right of action section.

How do you respond to that set of criticisms? Mr. Atwater, why don't you start?

Mr. ATWATER. OK. Let me first address the private right of action. As I stated earlier in answer to some questions, currently the penalties that are available federally are very small—it's a $5,000 fine compared to the huge profits available. Private rights of action would put substantially more teeth into stopping these manipulative actions.

We've just finished addressing the second area that you brought up, which is the question of Federal preemption versus State governance. I think all the reasons that we have discussed would apply in answer to that and I guess I would add one other. The Capital Markets Group I think raised the specter of having to have each transaction go through 50 States. As a matter of fact, a corporation is only incorporated in one State and it is only the laws of that State that deal with those matters and, frankly, when you have a 100-percent acquisition, there are no State laws that would stop that.

And there is absolutely no evidence in the way we're working now, which is under an appropriate State-Federal split, that takeovers have been in any way inhibited. As a matter of fact, to the contrary, Senator, we've never had a greater number of takeovers. So it's awfully hard for me to see the argument that somehow the current State-Federal split is causing a problem.

Mr. TROWBRIDGE. Senator, I won't expand on Mr. Atwater's comments except to note that current law allows private right of action for fraud purposes. The recommendation under S. 1323 would allow private right of action for violation of a disclosure of intent to invest and not holding that investment for a 6-month period. It seems to me that's a positive step and I would support it.

Senator RIEGLE. Mr. Clark, do you want to add anything?

Mr. CLARK. I would just add one point, Senator, and that would be the restrictions on corporate defenses. I think it has to be reemphasized that corporate defenses have been a reaction to a weakness in the current system and I doubt that there are very many managements who would disagree that there have been abuses in the system. So it's the corporations' way of trying to protect the shareholder.

Let me point out one example. The SEC filed an amicus brief in the *Household* case in the State of Delaware and suggested that the adoption of a rights plan, known as a poison pill, was an end to all hostile takeovers. Well, they have been proven wrong in their position.

In a recent study they indicated that 30 companies with so-called poison pill plans were the subject of takeover activity and I believe 16 of those companies were taken over.

So I think it has been a necessary reaction on the part of management and I think we have to also agree that whatever rules and regulations this committee comes out with, there will be an awful lot of smart, well-paid people trying to figure out new methods of attack, new methods of getting hold of the substantial amount of moneys that are being gathered in as a result of takeover activities.

My fear is trying to put a shackle on management which is truly interested in the rights of the shareholders.

Senator RIEGLE. Let me ask you this. Earlier, Mr. Atwater, you presented us with a diagram that I think makes a very compelling case about how companies are being put into play.

I don't know if you happened to hear or read the testimony of Beryl Sprinkel on behalf of the administration, but the view of the administration—the official stated view of the administration here is that everything is fine, there are no problems out there.

How do you make any sense out of or how do you account for the fact that if the problem is what you in effect all say it is, we've seen so little action by the SEC? I mean they have brought some cases, but in terms of rulemaking efforts or other things that would show a real step in this direction we haven't seen much, and in the administration we've seen virtually nothing, zero. In fact, their stated view is things are fine and dandy.

Why aren't you able to make your case there if there's a case to be made?

Mr. ATWATER. I read with great interest Beryl Sprinkel's testimony and I think it depends on what level you approach this thing. They are approaching it on a theoretical, economic basis that basically says free markets are terrific and therefore anything that happens in a free market has got to be OK.

We are approaching it in terms of what actually happens out there. There is manipulation out there. It is economically disastrous for uninformed shareholders, for bondholders, for communities. You know all this and I don't have to go into that in detail.

Their economic studies on shareholder wealth remind me a little bit of the statistical relationship between the increase in the number of Baptist ministers and the increase in the consumption of bourbon. I mean the two things aren't necessarily related. And when you study what's happened to share price in a short period of time, it does not really get at the shareholder wealth issues. You are taking from bondholders to give to shareholders. You are taking from charitable contributions and giving to those shareholders out there. That is where the problems are, Senator.

I think when the administration—whom we've just begun to work with—starts to look at the details of what really goes on, they are going to come to the same conclusions you come to.

Senator RIEGLE. Well, I know, but something doesn't add up here because if the problem is as pervasive as you present it—and this didn't happen yesterday. This has been happening over a long period of time and we've talked about the scale—I gather you can measure this problem now not just in tens of billions but hundreds of billions of dollars.

Mr. ATWATER. Absolutely.

Senator RIEGLE. And what I don't understand is why an organization as strong and as well-connected as The Business Roundtable or any of your organizations would not have been able somewhere along the line to convince the administration or the SEC that this is a serious problem that needs action.

You make it sound as if you've just started those conversations. Is that really the case, or have you had conversations going on over a lengthy time and, if not, why not?

Mr. ATWATER. That is actually the case. I'm the leader on this and I met with Secretary Baker just last week for the first time and I had one meeting with Chairman Shad not more than a month or so ago. We have really elected to work with your committee and in Congress and we're just moving our work to that forum.

I think this area is complex and my experience is that it takes about an hour to sit down with somebody and really get them to understand what goes on and that job just plain has not been done yet.

Senator RIEGLE. Well, it sounded to me—I don't know whether Jim Baker talks to Beryl Sprinkel or whether you were persuasive in your meeting with him, but I must say, Mr. Chairman, we just had the administration's chief spokesman in here a matter of literally hours ago, and he basically said everything is fine.

Mr. ATWATER. Well, quite clearly, everything is not fine.

Mr. TROWBRIDGE. Senator, I think if we were to poll the members of the National Association of Manufacturers on the question, "do you favor more or less Government regulation of business?" the answer would be that we favor less. If we were then to say, "do you feel that the current situation in which hostile takeovers are running rampant through the economy is being done under fair rules and with benefits for the economy and the shareholders?" most would say no.

We have talked with Mr. Sprinkel and Chairman Shad over the last several years, as a matter of fact, in conjunction with Senator Wirth's hearings which he held during the period when he was in the House of Representatives. We have been developing our attitude toward this problem along with the Congress and I think Mr. Sprinkel's position is fairly consistent with his outlook on life. That is, the free market per se is the end all and be all.

He took that position on the question of the impact of the strong dollar on the exports of the United States for 3 or 4 years. It took some argumentation and convincing to involve Secretary Baker in changing that posture and in working on it to the advantage of the United States.

Mr. Sprinkel's position is at least consistent.

Senator RIEGLE. Well, it isn't just his position. It's the President's position. It's the position of the administration. He wasn't just here speaking as an individual.

Mr. TROWBRIDGE. Well, I think that the Economic Policy Council of the administration will have to be the final point of review of whatever comes out of your efforts here in the Congress. I don't think their position is in concrete at the moment. There are other members of the Cabinet who look at this problem and see the same kind of problems we do.

The CHAIRMAN. Thank you, Senator Riegle. Your time is up. Senator D'Amato.

Senator D'AMATO. Thank you, Mr. Chairman.

Mr. Chairman, I would like at this time to put my statement in the record as if read in its entirety.

The CHAIRMAN. Without objection, it will be printed in full in the record.

Senator D'AMATO. Thank you.

STATEMENT OF SENATOR ALFONSE D'AMATO

"I don't think they play at all fairly," the statement began, in rather a complaining tone, "and they all quarrel so dreadfully one can't hear oneself speak—and they don't seem to have any rules in particular: At least, if there are, nobody attends to them—and you've no idea how confusing it all is. * * *"

When I initially read this I thought it was a quotation from one of the representatives of the business community complaining about the abuses perpetrated by corporate raiders. However, on closer examination I found that this was a statement uttered by the befuddled Alice in Lewis Carroll's fairy tale, "Alice's Adventures in Wonderland."

I cite this passage in an attempt to encourage the committee to concentrate on separating the facts about corporate takeovers from fairy tales. So let's look at some of the facts this committee has uncovered in its examination of corporate takeovers.

First, we have agreed that corporate raiders have engaged in certain tactics that have an adverse impact on workers, communities and sometimes provide little economic benefits for the economy. Therefore we must enact legislation to limit the number of acquisitions that are nothing more than pure financial plays. However, we are faced with the difficult task of remedying these abuses without chilling legitimate takeover activity or tipping the balance in favor of managements in contests for corporate control.

The difficulty of this task was articulated by one of our colleagues for whom I have great respect, Senator Bentsen, chairman of the Senate Finance Committee. In a May 15, 1987 appearance on the television show, Wall Street Week, Senator Bentsen was asked about the prospect of legislation restricting takeovers. After noting some of the issues on which the debate should focus, Senator Bentsen concluded:

> I think that its very difficult to put some kind of an economic ban by legislation. It is so difficult to write a piece of legislation that's going to apply uniformly to all types of acquisitions and mergers, and you can't put a stop to those.

Senator Bentsen articulated the dilemma facing us. How do we enact legislation that distinguishes between good takeovers and bad takeovers? Do we establish a Government-sponsored takeover review panel? Do we ban all forms of takeover activity and thereby ensure that the bad deal will not be made? Or should we just modify the current system of letting the shareholders, who are the true owners of the company decide how to dispose of their property? These are the basic questions that must be determined by this committee before we rush headlong into a scheme that encumbers the property rights of shareholders.

Second, on almost everyone's list of abusive tactics that must be remedied, we find the practices of greenmail, golden parachutes, and poison pills. What do these practices have in common? They are all practices engaged in by incumbent managements. Understandably, managements engage in these practices to save their necks. The self-preservation instinct demonstrated by corporate managers is admirable; however, does the tendency toward self-perpetration justify the use of tactics so detrimental to shareholder interests. Moreover, the SEC has published studies demonstrating the adverse effects of shareholders of share-repellents, poison pills and other defensive tactics.

Third, the debate about the economic benefits of corporate takeovers has just been joined. While my good friend and colleague Senator Proxmire cites several studies noting the negative impact of corporate takeovers, I can inundate him with studies, and will include some for the record, citing the beneficial effects of corporate takeovers on job formation, competitiveness, and productivity. The evidence suggests that, while all corporate takeovers may not prove beneficial to the economy, an overwhelming majority of them prove to be economically justifiable and viable. Further, I think it is too early for us to make a determination of the final outcome of this latest wave of corporate takeover activity. However, initial results prove them to have had positive impact. I think that before we decide to impede takeover activity it must be shown by at least a preponderance of the evidence that takeovers are an unnecessary evil. To date, for those who would want to impede takeover activity, the evidence on this issue is, at best inconclusive.

Fourth, any bill which slows down legitimate takeover activity, even if it is disguised under the rubric of tender offer disclosure and fairness is nothing more than an aid to dependent incumbent management bill. To greater and lesser extents each bill before us today would provide a greater degree of comfort to incumbent managements. While I don't mean for this to be a diatribe against the so-called corpocracy, I just can't bring myself to support the legislation that effectively insulates certain segments of the business community.

When the leaders of corporate America have asked for legislation in the past to protect them for the rigors of Japanese competition, I have supported it. When they asked for legislation to protect them from corporate raiders, I introduced it in the 99th and 100th Congress. However, when they ask for legislation that will protect them from the owners of the company, the shareholders, I draw the line. That is why I cannot support and will actively oppose many of the provisions in the legislative proposals before us this morning.

I believe the real dilemma confronting shareholders is the attempt to erode their voting power. If we take steps to enact legislation that minimizes the disciplining effect of takeovers, and permit the abandonment of the one share/one vote standard, then corporate managers are virtually unaccountable to the shareholders. It seems that management is so concerned about the shareholders' dilemma that many of the most vociferous advocates of takeover reform are the most willing to disenfranchise their own shareholders. These corporate leaders are at the forefront of the movement away from the one share/one vote capitalization standard for no legitimate reason other than to insulate management from shareholders. This attempt to disenfranchise shareholders is the real dilemma confronting shareholders.

Finally, we must realize that the market for corporate control is not static, it is constantly evolving. Three years ago, the bidders had the upper hand. Then a Delaware court upholds the use of poison pills and management has the upper hand. Then bidders develop new tactics and they have the upper hand. Then management works to enact second generation State antitakeover statutes, the Supreme Court upholds the Indiana law, and incumbent managements have the upper hand. Some think that the Court's decision will be the death knell for takeover activity and it just might. However, I don't think we should be the ones to enact legislation that would slow down the formation or impede the efficient use of capital. Further, many of the provisions of the bills before us could be adopted by the corporations themselves by amending their articles of incorporation and bylaws. Shouldn't corporate managers seek the approval of their shareholders before they seek a Federal remedy to their problems?

A little knowledge can be a dangerous thing. And that's all many of us have on the effects the legislative proposals before us today will have on contests for corporate control and the process of capital formation. The insight that tender offers can serve the important function of disciplining management in the modern corporation is undeniably a valuable one. In many instances, the tender offer has served that function admirably. On the other hand, we have witnessed certain abusive tactics attendant to corporate takeover activity and the use of these tactics must be severely restricted or eliminated. But the financial world is not so simple as Senators perceive it, economists assume it and law professors imagine it. While we have examined much anecdotal and some empirical evidence with regard to takeovers, we have yet to uncover the reasons for the growth of "merger mania" and ways to address abuses without impeding legitimate activity. Therefore, we should be wary of believing that simple legislative prescriptions will adequately address a complex phenomena.

Senator D'AMATO. In an article written by Professor Michael Jensen that will appear in a forthcoming book of Mr. Jensen, he argues that golden parachutes are desirable.

Do you believe that compensation packages such as golden parachutes are desirable and does the Federal Government have any business prohibiting or restricting them?

Mr. CLARK. Well, I find myself interestingly siding with Professor Jensen, who I don't often find on the same side.

I think it's a question of management's right to establish proper compensation boundaries. I believe that there are enough checks and balances within the system that any abuses can be corrected, either through the State courts or through the proxy mechanism.

So I think it's a question of taking away from management a compensation right and I think this falls under that broad heading of compensation in saying that you know better than the management that is on the firing line.

Senator D'AMATO. Mr. Trowbridge?

Mr. TROWBRIDGE. Golden parachutes per se are not designed as a compensation mechanism as much as they are as a means of allowing the management to devote their full attention to the operations of the company and the enhancement of the shareholders' value in it. Those parachutes are obviously abusive if they get so high that they cause the management to favor the quick disposal of the company at a higher price so that they personally can gain.

I think the generally current practice is the right practice. Whatever management and their shareholders agree to in terms of golden parachutes or severance arrangements in advance should be done clearly when the company is not under the gun as far as being a target.

Senator D'AMATO. Mr. Clark, what would you say with respect to Mr. Trowbridge's caveat as it relates to the use of golden parachutes, his last statement, which was that they should not be employed once a company is put into play? I think that's the point you were coming to but if they were a financial package and arrangement made prior to any offer being made he saw no problem with that?

Mr. CLARK. As a practical matter, I think that's the best way to go and I even think that——

Senator D'AMATO. Would you prohibit those new financial packages or inducements which we have termed in the art form golden parachutes, their coming into play or being once a company is put into play?

Mr. CLARK. I'm opposed to them because I think it takes a right away from management.

Senator D'AMATO. You're opposed to banning that kind of practice?

Mr. CLARK. Yes.

Senator D'AMATO. Even if there is no compensation package for a company official or it's one of let's say $50,000 a year for the next 3 years, and the company is put into play, and that package then goes up to $500,000 a year for the next 5 years, and that agreement wasn't there before, it just comes into being as a result of the company being put into play? Do you think that management should have that right?

Mr. CLARK. I think that management should have that right. Now I'm not suggesting that I would agree with such a decision. In my corporation we don't have golden parachutes.

Senator D'AMATO. OK. Let me move on to Mr. Atwater with another question, if I might, unless you want to give us a quick response to that.

Mr. ATWATER. I would just like to comment on that, Senator. I think it's very important to take a look at why these arrangements were put in to begin with. The abuse of the raider that created these are the raider coming to the CEO of the company and making a very, very sweet arrangement if the CEO would endorse his bid. This is very cheap for the raider versus the huge profits he can make. And to fight against that, the corporations said, "Look, we want you to be neutral working for the shareholders in this matter. We will set up an arrangement whereby you won't be hurt if a tender goes forward." So that's where these things came from.

The only other point I would make is that I do not think, as we discussed before, that shareholder rights plans or golden parachutes are the central issue here. The central issue is the process.

Senator D'AMATO. Let me if I might—and I think I'm already running over the time limit. That little red light has come on. If I might be indulged by the chairman and ask one question.

Tuesday several witnesses, especially those on the second panel, suggested that "abusive tactics used to defend against corporate takeovers were issues of corporate governance that should be regulated by States." Then they went on to say that "the tactics employed by bidders such as partial, two-tier offers, were practices that should be regulated by amendments to the Williams Act, Federal legislation."

Do you see any problems, Mr. Atwater, with this type of bifurcation of regulation of offensive and defensive tactics?

Mr. ATWATER. Senator, I think the real issue that the committee here is dealing with is shareholder protection and the process. And I think insofar as you focus on trying to put sanctions in against raiders or sanctions in against management, you're really looking at symptoms of a process that's got some problems in it.

As we discussed here earlier, with some very, very simple fixes in disclosure and in requiring over a certain percentage people to go for 100 percent of the stock, which is 95 percent of what goes on in the United States, all of these other issues will go away. They are all secondary, symptomatic issues.

Senator D'AMATO. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator D'Amato.

Gentlemen, we have four other distinguished witnesses. Would each of you drop us a note and put it in writing as to whether or not you feel this is an urgent problem requiring our immediate attention? We would like to have your response to that. Thank you very much.

Our next witnesses are Raymond Sweeney, cochairman of the Council of Institutional Investors, general counsel, Sheetmetal Workers National Pension Fund; Harrison Goldin, cochairman, Council of Institutional Investors, New York City Comptroller;

James Martin, executive vice president and chairman of the CREF Finance Committee, College Retirement Equities Fund, New York; and Ms. Margaret Cox Sullivan, president of the Stockholders of America, Washington, DC.

Mr. Sweeney, go right ahead, sir.

STATEMENT OF RAYMOND J. SWEENEY, COCHAIRMAN, COUNCIL OF INSTITUTIONAL INVESTORS

Mr. SWEENEY. Thank you, Mr. Chairman.

My name is Raymond J. Sweeney. I am the general counsel for the Sheetmetal Workers National Pension Fund. I am also cochairman of the Council of Institutional Investors. I should preface my remarks by saying that my comments are not the comments of the Council of Institutional Investors. They are my comments and the comments of my client.

The Council, however, is composed of approximately 50 pension plans, pension plans both from the municipal sector, the corporate sector, Taft-Hartley funds, and State pension plans.

The Council's assets today are in the range of $200 billion. The Council was organized in January 1985 to address many of the issues that your legislation seeks to address.

It is widely known that the Council has as members many of the largest institutional investors in the United States. Furthermore, it is also widely known that institutional investors now own approximately 40 percent of the stocks publicly traded and it is estimated that within less than 10 years institutional investors will own more than 50 percent of the stocks currently traded.

However, it is less widely known that the Council of Institutional Investors actually represents 5 million employees, retirees, and their beneficiaries. It is the protection of the interests of those 5 million pension plan participants that I would like to focus the committee's attention upon this morning.

SUPPORT FOR LEGISLATION

I fully support the provisions in the legislation which increase the penalties for insider trading, perjury, and the obstruction of justice.

I also fully support limitations on tactics which provide certain shareholders with opportunities to maximize the value of their assets at the expense of other shareholders. I am speaking specifically of greenmail. Greenmail benefits only corporate raiders and management. It dilutes the value of our holdings. Equal treatment should be afforded to all shareholders.

I also fully support restricting the use of poison pills and golden parachutes. I would recommend, however, that these provisions on defensive tactics be broadened so as to subject such tactics to a shareholder vote at any time management wishes to add them to their arsenal of defenses, not just during the course of a tender offer.

Such defensive tactics, I submit, deprive the owners of their basic right to determine whether or not to sell their stock and who should control the corporation. The choice of whether or not to sell belongs to the shareholder. Management should not be allowed to limit that right.

Although institutional investors are looking for the best price, we should not be mistaken. Institutional investors are concerned about the long-range competitiveness of the American economy. The argument has been made that we are only interested in short-term profits. That is simply not so. We invest in the long term.

Since the question of job loss resulting from certain takeovers has already been extensively reviewed with the committee by the secretary-treasurer of the AFL-CIO and William Wynn, general president of the United Food and Commercial Workers, I will not dwell on that point. However, let me make one point.

I submit that to the extent that there is a job loss related to takeovers, it is because management has failed, not the American worker. There is absolutely nothing wrong with the American worker. Thus, the Government's response should not be to protect management by limiting takeovers. On the contrary, Government should remove those abuses in the takeover process which, in the words of President Wynn of the United Food and Commercial Workers, "have resulted in a transfer of wealth from Main Street to Wall Street. That is in no way conducive to the steady and strong growth of the American economy."

I am pleased to see that the financing provisions were intentionally excluded from this legislation. It is important for the capital markets to function with as little regulation as possible. Innovative financing has, when properly used, encouraged corporate growth resulting in increased returns to shareholders, and expanded job opportunities for the American worker.

Although I generally support the sponsors of this legislation, there are four provisions with which I would like to draw your attention. One, the question of preemption; two, the question of the 13(a) filing threshold; three, creeping tender offers; and four, ERISA exemption.

My greatest concern, however, is over the so-called reverse preemption. Such a provision would destroy any uniformity being created by the legislation you currently seek to enact. This provision would make it possible for each State to have its own antitakeover measure. It is in the national interest to maintain Federal control over corporate mergers and acquisitions which have national scope and impact.

If this provision is enacted, States may seek to protect individual corporations located within their boundaries without fully examining and analyzing the consequences that such local action may have on the national economy.

Another problem that large institutional investors have with this proposed legislation involves the section 13(a) filing threshold. Lowering the threshold from 5 percent to 3 percent would substantially increase our reporting requirements and could be an administrative nightmare for the Council's members and for the SEC.

Large funds such as some of the member funds of the Council of Institutional Investors frequently obtain or acquire between 3 percent and 5 percent of a particular corporation's stock with absolutely no intention of gaining control of that corporation.

For example, the California Public Employees Retirement System currently holds between 2 percent and 4.5 percent of the stock in 42 different companies. Another example, the State of Wisconsin Investment Board now holds over 3 percent of the stock of 27 companies. These are just two funds or two examples of the Council's 50 member funds.

In addition, since many of our members are in "indexed funds", the administrative problems are compounded. In such cases, a 3-percent requirement would encourage members and other institutional investors to simply stop investing in small cap stocks that have been shown to be more labor intensive than larger companies. This would effectively reduce the amount of money available to companies that are America's best source of jobs, and jobs, I once again submit, is our primary concern.

Turning to the question of ERISA——

The CHAIRMAN. Could you wind up, Mr. Sweeney, in about a minute?

Mr. SWEENEY. Yes, Mr. Chairman. I would simply like to point out that we should not carve out an exception to the ERISA prudent management rule in tender offers because if such an exception is carved out pension fund investors, who are there for the long term, would have difficulty in rejecting tender offers.

In conclusion, Mr. Chairman, let me simply close on a note on which I began. As general counsel to the Sheetmetal Workers National Pension Fund, I support S. 1323 insofar as it directly protects that plan's assets from the recognized abuses. Thank you, Mr. Chairman.

[The complete prepared statement of Raymond J. Sweeney follows:]

TESTIMONY OF RAYMOND J. SWEENEY

BEFORE THE U.S. SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

RE: S.1323

Washington, D.C.
June 25, 1987

Mr. Chairman, my name is Raymond J. Sweeney, counsel to the Sheet Metal Workers National Pension Fund and co-chairman of the Council of Institutional Investors. I am honored to be here today to discuss S.1323, the "Tender Offer Disclosure and Fairness Act of 1987." The Council does not have an official position on the bill and my comments reflect my interests and the interests of many members, but are not meant to express the views of the Council per se.

The Council is comprised of fifty (50) state, municipal and union pension funds. Together, we manage over $175 billion in pension assets and represent some of the nation's largest shareholders. The Council was organized in late January, 1985, to assert shareholder rights and to correct many of the identical problems addressed in S.1323, including greenmail, poison pills, golden parachutes and other practices which tend to treat shareholders unfairly.

It is widely known that the Council has as members many of the largest institutional investors in America. Furthermore, it is frequently acknowledged that institutional investors currently own 40% of the equities traded in the U.S. capital markets and will likely increase their share to 50% in another ten years. However, it is less widely appreciated that the Council represents over five million employees, retirees and beneficiaries in over 30 states whose secure retirement depends on the healthy functioning of both the American capital markets and the corporations that are their basic building blocks. My testimony is directed primarily at the protection of these employees, retirees and their beneficiaries.

I am pleased to see that this committee is dedicated to solving many of the problems which have developed in the financial markets. I agree with Senator Riegle's statement that "full and timely disclosure about a tender offer is in the best interests of an efficient capital market and responsible shareholder decision-making." It is the shareholders who are harmed by lack of information and disparate treatment.

I fully support those provisions in the legislation which increase the penalties for insider trading, perjury and obstruction of justice. These are good provisions which should help deter illegal conduct by raising its costs to the individuals involved.

I support limitations on the tactics which restrict the opportunity for certain shareholders to maximize the value of their assets. In particular, I favor prohibiting the use of greenmail by issuers who buy back their shares at a premium from those investors who have held a three or more percent stake in the company for less than six months. Greenmail benefits only raiders and management and dilutes the value of our holdings. Equal treatment should be offered to all shareholders.

I support restricting the use of poison pills during a tender offer which can reduce the value of a company's stock by preventing potentially beneficial offers. The use of golden parachutes should also be limited. Quick profits and entrenched management are not conducive to the long-term health of corporate America. I would recommend that these provisions on defensive tactics be broadened so as to subject such tactics to a shareholder vote at any time management wishes to add them to their arsenal of defenses, not just during the course of a tender offer.

These three defensive tactics used by management to impede a takeover deprive the owners of their basic right to determine whether or not to sell their stock and who should control the corporation. The choice of whether or not to sell belongs to the shareholder and management should not be allowed to limit this right. Shareholders and pension funds are interested in getting the best price possible for their stock and takeovers can serve a vital function by increasing the market value of a stock to more nearly correspond to the company's asset value.

Although institutional investors are looking for the best price, don't be mistaken. Institutional investors are concerned about the long-range competitiveness of American industry. The argument has been made that we are only interested in short-term profits. This is not so. We invest in the long-term.

The SEC in a 1985 study on institutional ownership refuted the short-term argument by establishing that institutional investors invest in companies with long-term research and development plans. We look for successful companies with effective management in which to invest our funds. However, we also believe the restructuring of corporate America should be encouraged wherever necessary to cut costs and produce more efficient companies which are able to respond to the challenge of both domestic and foreign competition, and thereby preserve and hopefully expand job opportunities for American workers. An expanding job force, not quick profits, is a key to the future of public and private programs.

Since the question of job loss resulting from certain takeovers has already been extensively reviewed by the committee in testimony presented by Thomas Donahue, Secretary-Treasurer, AFL-CIO, Jack Sheinkman, Secretary-Treasurer, Amalgamated Clothing and Textile Workers, and William Wynn, International President, United Food and Commercial Workers, I will not dwell on that issue. Rather, I will make one point. To the extent there is a job problem related to takeovers it is because management has failed-not the workers. There is nothing wrong with the American worker. Government's response should not be to protect management by limiting takeovers. On the contrary, government should remove those abuses in the takeover process which, in the words of

International President Wynn delivered at the committee's April 8, 1987 hearing, "have resulted in a transfer of wealth from Main Street to Wall Street that is in no way conducive to steady and strong growth in the American economy."

I am also pleased to see that financing provisions were intentionally excluded from this legislation. It is important for the capital markets to function with as little regulation as possible. Innovative financing has, when properly used, encouraged corporate growth, resulting in increased returns to shareholders and expanded job opportunities for American workers. Institutional as well as individual shareholders may be adversely affected by any limitations on financing which might compel companies to retain their earnings instead of declaring dividends.

Although I support the efforts of the sponsors of this legislation, Mr. Chairman, there are some provisions with which I have concerns. My greatest concern is over so-called "reverse preemption." Such a provision would destroy any uniformity being created by the legislation you currently seek to enact. This provision would make it possible for each state to have its own anti-takeover measure. It is in the national interest to maintain federal control over corporate merger and acquisitions which have national scope and impact.

If this provision is enacted, states may seek to protect individual corporations located within their boundaries without examining the consequences their actions may have on the nation. Management in those states would become more firmly entrenched and less accountable to their shareholders. This does not mean that there should be no role for the states in controlling the companies incorporated and doing business within their boundaries. The states should continue to govern the internal affairs of those businesses with substantial contacts in their state. However, allowing the states preemption over federal law could be disastrous for the competitiveness of American corporations.

Funds like ours with nationwide holdings cannot look with favor on any provision that encourages further Balkanization of our financial markets at a time when markets are becoming increasingly more international.

Another problem large institutional investors have with the legislation involves the Section 13(a) filing threshold. Lowering the filing threshold from 5% to 3% would substantially increase our reporting requirements and could be an administrative nightmare for Council members as well as the SEC. Large funds, such as our member funds, often purchase between 3% and 5% of the stock of a company with no intention to gain control of the management of that company. For example, the California Public Employees Retirement System currently holds between 2% and 4 1/2% of the stock of 42 different companies. The State of Wisconsin Investment Board holds over 3% of the stock of 27 companies. These are just two funds, and the companies involved are all large companies.

Since many of the Council members' funds are in index funds the administrative problems are compounded. In addition, a 3% requirement would encourage members and other institutional investors to cease their efforts to invest more heavily in smaller cap stocks that have been shown to be more labor intensive than larger companies. This could reduce the amount of money available to companies that are America's best source of jobs. And jobs are one of our primary concerns.

I do not request a carve-out for pension funds. Such a carve-out would be based on the assumption that pension funds are only passive investors. This is increasingly not the case, and we cannot as fiduciaries ask to be restricted to a passive role. Closing the ten day window under Section 13(d) which I support should solve the same problems meant to be remedied by lowering the filing threshold.

Another area of concern involves the so-called "creeping tender offers" where acquisitions resulting in ownership in excess of 15% of any class of stock must be by tender offer. It is possible that institutional investors will someday seek substantial holdings in a company in order to get management to take notice of their concerns. This provision would require those funds to pay a higher price than the prevailing market price with only a 15% stake in the company.

A final area of concern I have as legal counsel to an ERISA covered pension fund is the proposal in S.1323 to carve out an exception to the ERISA prudent man rule in tender offer situations. As pension funds are investors for the long term, I believe that where appropriate a fiduciary may lawfully reject a tender offer in reliance upon the ERISA prudent man rule. The proposed change to ERISA goes so far to discourage decisions to tender that it displaces the exercise of discretion under the prudent man rule by the fiduciary charged with making investment decisions. This approach is not only unnecessary but sets the unwelcome precedent of legislatively mandated investments.

Our responsibilities as fiduciaries require us to be active participants in the corporate governance process, where necessary and appropriate. For this reason, I would like to see provisions added to the bill which would make shareholder participation more effective, including access to the proxy process and reform of the voting system. Also, some institutional investors have reportedly been subject to pressure to support management on controversial voting questions which can create a conflict with their fiduciary duty. I would like to see a confidential system of proxy voting which would eliminate these pressures. If such reforms are enacted, the need for further legislation may be averted because those with the greatest interest in supporting America's corporations -- its millions of owners, many of them pensioners -- will be more able to provide that support.

In conclusion, I believe that the bill you have introduced Mr. Chairman, S.1323, represents a substantial step forward. I appreciate the opportunity to be here today, involved in this important legislation. I thank you for allowing me to share my views and am prepared to answer any questions you may have.

The CHAIRMAN. Thank you, sir.

Mr. Goldin, you're an old friend of the committee. We are delighted to have you back. You're doing a brilliant job up there and go right ahead.

STATEMENT OF HARRISON J. GOLDIN, COCHAIRMAN, COUNCIL OF INSTITUTIONAL INVESTORS

Mr. GOLDIN. Thank you very much, Mr. Chairman. That's very generous of you.

Senator D'AMATO. Mr. Chairman, if I might, I would like to add a little aside. Harrison Goldin has been in the forefront of recognizing the problems that the shareholders and pension fund managers have, has nationally brought together a group and an organization to deal with this, has done an outstanding job in this area. Not only has he been an outstanding comptroller of our city, but in addition, in terms of addressing this overall problem, and I might go on to say that he has submitted to us—I don't know if he's going to read this verbatim—but he has submitted an absolutely outstanding statement and I commend him for his very, very balanced presentation, at least that has been submitted to us at this point.

The CHAIRMAN. Go right ahead, Mr. Goldin.

Mr. GOLDIN. Thank you very much. I appreciate this opportunity to contribute to the national debate on the appropriate governmental response to hostile corporate takeovers and defensive responses by management.

You have heard from academicians, Government officials, business executives, investment bankers, and lawyers. I represent a group that is at the base of the entire system you've spent 2 days discussing—shareholders.

As comptroller of the city of New York, I am asset manager, custodian or trustee of five public employee pension funds whose aggregate assets exceed $32 billion. Those assets, which are invested in more than 1,300 American companies, represent the retirement security of more than half a million current and former New York City employees.

While I speak today directly only for them and the people of New York and the pension funds under my jurisdiction, I am also a cochair of the Council of Institutional Investors.

Arguably, I do not represent the prototypical, small, independent shareholder, but I am a shareholder nonetheless. Indeed, I increasingly personify the shareholder of the future, for, as you know, the proportion of the investment universe represented by institutions continues to grow. In a sense, my concern and those of my fellow public pension fund managers extend beyond those of the traditional shareholder. While we act for ourselves and our beneficiaries, we also vindicate the interest of millions of American taxpayers who contribute to public employee pension plans.

The Council of Institutional Investors is principally a vehicle for the exchange of information. As fiduciaries, its members cannot and do not delegate their trusteeship. But it is helpful to us and those we represent to be able to exchange and receive information that enables us better to make independent decisions that protect and leverage our assets.

The Council was established as a direct response to certain defensive actions by corporate managements to thwart attempted hostile takeovers, actions which give rise to both real and potential asset value losses, actions which tend to dilute shareholder participation in the affairs of their companies.

I deliberately said the Council was formed in response to corporate actions which do or can affect the value of our assets. I did not say we banded together to oppose those types of actions, for that is not our purpose.

Rather, we seek a constructive dialog not only with the corporate managers to whom we've entrusted the assets of those we represent, but with the public officials who set the rules by which corporations are governed in this country. We want to leave law making to the legislators, rule making to the regulators, and judicial interpretation to the courts. But we want them to leave fundamental questions as to the governance of corporations to the owners, to us, the shareholders.

Note I said the governance of corporations should be left to us, not their operation. We are neither interested in nor equipped to assume that responsibility. It is the prerogative of management and we have essential confidence in it or we would not likely have made the investment in the company in the first place.

We tie the future security of the workers we represent to our Nation's securities markets because we consider participation in that system the most effective and efficient way in which to guarantee their retirement. But more and more because of the exponential growth of pension assets, we are becoming the market. It should not, therefore, come as a surprise that we examine critically any attempt to tinker with the orderly operation of the market.

Mr. Chairman, members of the committee, I do not mean to suggest that we see no room for governmental involvement. Your own efforts to increase the degree of required investor disclosure is a good example of the constructive role of Government.

We support the closing of the 10-day window. We favor an extension of the tender period. We in the public sector especially appreciate the importance and value of our business being conducted openly. Clearly, businessmen can and should learn to conduct their affairs that are invested with the public interest similarly.

We applaud your efforts to stiffen penalties for illegal use of nonpublic information. Only in that way can a level playing field for all be preserved. We agree that Government should seek to prevent and vigorously prosecute fraud.

We are of like mind about the need for regulation of poison pills, golden parachutes, and greenmail. We, however, would go further, prohibiting them altogether without the approval of a majority of disinterested shareholders.

TROUBLE AREAS OF PROPOSED LEGISLATION

Two aspects of your proposed legislation trouble me. One is your definition of a group of investors. In an appropriate attempt to limit the ability of investors to conspire to evade reporting and other requirements, you may have expanded the meaning of the concept to preclude such informational organizations as the Council of Institutional Investors.

Second, your definition of a tender offer arbitrageur should exclude public pension funds, as it does ERISA funds.

My primary concern today, though, is with a fundamental principle of Government that ought to apply properly to business. It is accountability. We know that accountability in Government promotes a high degree of care. That's the foundation of our political system and that's what we should require from our corporate leadership too, accountability.

As shareholders, we reject the notion that we need protection from ourselves, but we do need protection of our basic rights. Companies are in the main governed by State law and bidders by Federal law. Where does that leave the shareholder?

As investors whose participation in the Nation's securities markets is central to the essential purpose of those markets, namely to facilitate capital formation and transfer in the interest of growth and a fuller realization of the value of assets, as investors whose general interest is in the long-term growth of corporate America, we have confidence in our ability to decide what is best for us and how to protect ourselves if we're given the chance.

This committee can advance that goal, promoting the proposition that the democratic ideals which make this country great ought to apply to the governance of corporations which raise capital in or rely on the liquidity of the public credit markets.

Respecting an important area of corporate governance in which the basic principle of democracy, full enfranchisement, is often denied, I urge that this committee consider mandating for shareholders the elemental rights of citizenship—the right to elect directors and make decisions through referenda by secret ballot, the right of one-share-one-vote, the right to approve certain critical decisions that affect the value of assets, such as poison pills, golden parachutes, and greenmail.

As shareholders, we are not to be feared by corporate managers. Our interests are identical, our goals the same: To see our assets grow in value. To them, I say that, unfortunately, strong language is sometimes necessary to make them listen. The Council of Institutional Investors met recently with the most senior officials of the largest corporation in America, General Motors. Chairman Smith and his colleagues found us willing to listen and cooperate. Representatives of The Business Roundtable attended our annual meeting last month. We found common ground.

Our systems of Government and business are inextricably entwined. Both are founded on the same democratic ideals. Those ideals are what make them so extraordinary and so resilient. We should seek to strengthen them in the one as we would in the other. Thank you.

[The complete prepared statement of Harrison J. Goldin follows:]

The CHAIRMAN. Thank you very much, Mr. Goldin.

Mr. Martin, you're the executive vice president and chairman of the College Retirement Equities Fund I understand.

Mr. MARTIN. Yes, sir.

The CHAIRMAN. That's a very important operation, and we're delighted to hear from you.

STATEMENT OF JAMES S. MARTIN, EXECUTIVE VICE PRESIDENT AND CHAIRMAN, CREF FINANCE COMMITTEE, COLLEGE RETIREMENT EQUITIES FUND

Mr. MARTIN. Thank you, Mr. Chairman. We are certainly pleased to have the opportunity to comment on S. 1323. Perhaps I should spend a moment describing who we are. The College Retirement Equities Fund, better known as CREF, is the equity component of the Nation's largest private pension system and, together with our affiliated company, Teachers Insurance and Annuity Association, or TIAA, we invest the pension contributions of about 1 million employees of higher education and related institutions.

The assets of the combined company exceeds $60 billion, of which CREF accounts for roughly $30 billion, invested largely in stocks of about 1,500 corporations in the United States. We believe ourselves to be the largest single equity portfolio in the country and possibly in the world.

The CHAIRMAN. Sixty billion dollars?

Mr. MARTIN. Sixty billion dollars for the combined pension plan, Senator. The CREF equity side, about $32 billion the last count. I don't know what the market is doing this morning. It may be $26, who knows?

Mr. GOLDIN. Or $35.

Mr. MARTIN. We are among the largest shareholders in American corporations and as a large shareholder we take our responsibilities very seriously and feel we should speak out on matters that affect the value of our investments in the interest of those who have committed their pension contributions to us.

In this regard, I should say we strongly disagree with accusations that institutional investors are not mindful of the long-term interest of corporations in which we own securities, and that we're concerned only with short-term profits. Nothing could be further from the truth. CREF probably epitomizes, along with institutions that are represented by the Council of Institutional Investors, the archetypical long-term investor. Our clientele is going to be with us for 40 or 50 years, so we have that kind of time horizon in mind.

In CREF's case, the vast majority of the holdings that we have have been held in excess of 5 years. We have many holdings that have been held as long as CREF has been in existence and that's been since 1952. We have no particular interest in a fast buck turnover of our portfolio and maximizing short-term profits and we spend a great deal of our effort and our resources examining the long-term potential of our portfolio companies and we look well beyond the next quarter or the next year.

In fact, we believe that, in general, evidence shows that institutional ownership has in fact been beneficial to the long-term interest of corporations and we find, for example, that companies with large institutional ownership tend to spend more on long-term R&D than do other companies.

We testified previously before Senator Metzenbaum's committee a month or two ago that we do believe Federal legislation is required to correct certain abuses which we think have developed on both sides of the takeover process.

Legislation must, however, maintain that neutrality and balance which we believe is essential to protect both large and small shareholders and we believe that for the most part the legislation which has been proposed here meets that objective.

We continue to believe that the tender offer itself is largely a beneficial transaction for shareholders, one that has brought far more good than harm to this country's shareholders, to our economy, and to our country as well, and legislation should, of course, seek to preserve, not destroy those benefits.

BAN GREENMAIL

Our views on two of the more—I would say most notorious takeover abuses, that being greenmail and poison pills, are pretty well known. We have been active for some time in seeking Federal legislation against greenmail. We think that benefits only raiders and incumbent management and is a direct steal from the pockets of the average shareholder. And we would fully support legislation on banning greenmail.

On the subject of the poison pill, we find that particularly troublesome and we have again supported legislation to restrict it because we think poison pills do in fact deprive shareholders of a basic right, that being to evaluate for themselves all offers for their shares. There is a fair amount of evidence to indicate that those companies that have instituted poison pills see the market value of their shares decline and shareholders lose when poison pills are adopted.

Poison pills give management authority that they have never had in the past and probably should not have, and that is to decide to whom and at what price to sell the company. Poison pills deprive shareholders who are in fact the true owners of the corporation of their fundamental right to decide for themselves whether to sell or hold their stock and who should control the corporation which they own.

We have no objection to an outright prohibition of poison pills, but we are not certain this is necessary. It would be sufficient, in our opinion, to require that poison pills be prohibited unless approved by a company's shareholders. As some of you may know, we have initiated a number of proxies in this past season to that effect, as members of the Council have as well, and I think the reaction to that, the vote that was received, was an outstanding victory for shareholder rights and shareholder democracy and I think substantial progress was indicated by the result of that undertaking.

We would comment that we would agree with Senator Metzenbaum's comments before this committee with respect to poison pills. That is, we would go beyond prohibiting their adoption during a tender offer and would require that any poison pill to be adopted be submitted to shareholders for approval before being adopted and, in fact, would probably go further and try and introduce some retroactivity into that. I'm not a lawyer so I don't know what the constitutional issues might be. The fact is, we have hundreds of poison pills already in place and this may be a little bit locking the barn after the horse has been stolen.

With respect to the 13(d) window, we support that provision. We support reducing the 10-day filing period to 1 day. We do believe that it's not necessary to reduce the 5 percent threshold to 3 percent. I don't think it would be an enormous burden, but it is an additional burden. There are certainly investors such as ourselves who a 3 percent holding don't represent a threat to seeking control of a corporation.

CREF at the present time has 32 holdings in which we exceed 3 percent of the outstanding shares and the number close to that is increasing rapidly.

It almost might be unduly rigid to prevent an investor on the subject of the 6-month provision—that might be unduly restrictive. We think there are legitimate reasons why intentions could change within that period. I would think that the provisions for enforcing 13(d) are sufficient to police that particular part of it.

We strongly favor provisions on the subject of creeping tender offer and sweeping street sweeps. On the subject of banning two-tier offers, we note that the bill does not provide for prohibiting that and, as we all know, the SEC has studied this issue and finds there is no evidence that shareholders have suffered by virtue of two-tier takeovers and, in fact, those that have taken place the results have been substantial premiums being paid to shareholders.

We support extending the duration of tender offers to 35 business days. We think that gives legitimate bidders—it doesn't allow undue delay and undue opportunity for managements to defend against them and do things that perhaps are inappropriate.

In terms of the right of pension fund managers to take into account long-term investment prospects in determining whether to tender their shares, I think we have always done that. I think decisions are made based on those kinds of judgments. So we would certainly support anything that supports taking a longer-term view.

On the subject of the provision in the bill relating to the States' role on corporate governance, we are a bit uncertain about that provision. While States, we believe, should continue to regulate the basic governance of corporations, the suggested provision appears to be too vague and indefinite to give meaningful guidance to either the State legislatures or to the courts that will be interpreting it. Particularly, we are worried about anything that might be interpreted as authorizing, if only by implication, State legislation which might substantially delay, deter, or impede tender offers. Any such State legislation would be particularly unnecessary if the extended offering period provided for in the bill is adopted and if the prohibitions against abusive acquisition tactics, such as creeping tender offers and street sweeps are enacted.

Thank you very much.

[The complete prepared statement of James S. Martin follows:]

TESTIMONY BY
NEW YORK CITY COMPTROLLER HARRISON J. GOLDIN
SENATE BANKING COMMITTEE
HEARING ON CORPORATE TAKEOVER LEGISLATION (S. 1323)
ROOM SD-538, DIRKSEN SENATE OFFICE BUILDING
WASHINGTON, D.C.
THURSDAY, JUNE 25, 1987; 10:00 A.M.

Senator Proxmire, members of the Committee: I appreciate this opportunity to contribute to the national debate on the appropriate governmental response to hostile corporate takeovers and defensive responses by management.

You have heard from academicians, government officials, business executives, investment bankers and lawyers. I represent a group that is at the base of the entire system you have spent two days discussing: shareholders.

I am a shareholder myself. And as Comptroller of the City of New York I am asset manager, custodian or trustee of five public employee pension funds whose aggregate assets exceed $32 billion. Those assets, which are invested in more than 1,300 American companies, represent the retirement security of more than half-a-million current and former New York City employees. While I speak today directly only for them and the people of New York and the pension funds under my jurisdiction, I am also a co-chair of the Council of Institutional Investors.

Arguably, I do not represent the prototypical small, independent shareholder. But I am a shareholder nonetheless. Indeed, I increasingly personify the shareholder of the future, for, as you know, the proportion of the investment universe

represented by the institutions continues to grow. In a sense, my concerns and those of my fellow public pension fund managers extend beyond those of the traditional shareholder; while we act for ourselves and our beneficiaries, we also vindicate the interests of millions of American taxpayers who contribute to public employee pension plans.

The Council of Institutional Investors is principally a vehicle for the exchange of information. As fiduciaries, its members cannot and do not delegate their trusteeship. But it is helpful to us--and those we represent--to be able to exchange and receive information that enables us better to make independent decisions that protect and leverage our assets.

The Council was established as a direct response to certain defensive actions by corporate managements to thwart attempted hostile takeovers, actions which give rise to both real and potential asset value losses, actions which tend to dilute shareholder participation in the affairs of their companies.

I deliberately said the Council was formed "in response" to corporate actions which do or can affect the value of our assets. I did not say we banded together to oppose those types of actions; for that is not our purpose.

Rather, we seek a constructive dialogue, not only with the corporate managers to whom we have entrusted the assets of those we represent, but with the public officials who set the rules by which corporations are governed in this country. We want to leave law-making to the legislators, rule-making to the regulators and judicial interpretation to the courts. But we want them to leave fundamental questions as to the governance of corporations to the owners--to us, the shareholders.

Note, I said, the "governance" of corporations should be left to us, not their operation. We are neither interested in nor equipped to assume that responsibility. It is the prerogative of management; and we have essential confidence in it or we would not likely have made the investment in the company in the first place.

We tie the future security of the workers we represent to our nation's securities markets because we consider participation in that system the most effective and efficient way in which to guarantee their retirement. But more and more, because of the exponential growth of pension assets, we are becoming the market. It should not, therefore, come as a surprise that we examine critically any attempt to tinker with the orderly operation of the market.

Mr. Chairman, I do not mean to suggest that we see no room for governmental involvement. Your own efforts to increase the degree of required investor disclosure is a good example of the constructive role of government. We support the closing of the 10-day window; we favor an extension of the tender period. We in

the public sector especially appreciate the importance and value of our business being conducted openly; clearly, businessmen can and should learn to conduct their affairs that are invested with a public interest similarly.

We applaud your efforts to stiffen penalties for illegal use of non-public information. Only in that way can a level playing field for all be preserved. We agree that government should seek to prevent and vigorously prosecute fraud.

We are of like mind about the need for regulation of poison pills, golden parachutes and greenmail. We, however, would go further, prohibiting them altogether without the approval of a majority of disinterested shareholders.

Two aspects of your proposed legislation trouble us. One is your definition of a "group" of investors. In an appropriate attempt to limit the ability of investors to conspire to evade reporting and other requirements, you may have expanded the meaning of the concept to preclude such informational organizations as the Council of Institutional Investors. Second, your definition of a tender offer arbitrageur should exclude public pension funds, as it does ERISA funds.

My primary concern today, though, is with a fundamental principle of government that ought properly to apply to business. It is accountability. We know that accountability in government promotes a high degree of care; that is the foundation of our political system. And that is what we should require from our corporate leadership: accountability.

As shareholders we reject the notion that we need protection from ourselves. But we do need protection of our basic rights. Companies are in the main governed by state law and bidders by Federal law; where does that leave the shareholder?

As investors whose participation in the nation's securities markets is central to the essential purpose of those markets, namely to facilitate capital formation and transfer in the interest of growth and a fuller realization of the value of assets, as investors whose general interest is in the long-term growth of corporate America, we have confidence in our own ability to decide what is best for us, on how to protect ourselves, if we are given the chance.

This Committee can advance that goal, promoting the proposition that the democratic ideals which make this country great ought to apply to the governance of corporations which raise capital in, or rely on the liquidity of the public credit markets.

Respecting an important area of corporate governance in which the most basic principle of democracy--full enfranchisement--is often denied, I urge that this Committee consider mandating for shareholders the elemental rights of citizenship: the right to elect directors and make decisions through referenda by

secret ballot; the right of one-share-one-vote; the right to approve certain critical decisions that affect the value of assets, such as poison pills, golden parachutes and greenmail.

As shareholders we are not to be feared by corporate managers; our interests are identical, our goals the same: to see our assets grow in value. Some may say that our rhetoric belies these lofty sentiments. To them I say that, unfortunately, strong language is sometimes necessary to make them listen. The Council of Institutional Investors met recently with the most senior officials of the largest corporation in America--General Motors; Chairman Smith and his colleagues found us willing to listen and cooperate. Representatives of the Business Roundtable attended our annual meeting last month; we found common ground.

Our systems of government and business are inextricably entwined; both are founded on the same democratic ideals. Those ideals are what make them so extraordinary and so resilent. We should seek to strengthen them in the one as we would in the other.

Thank you. I invite your questions.

Finally, we are somewhat skeptical of the general provision in the Bill relating to the states' role in corporate governance. While the states should, of course, continue to regulate the basic governance of corporations, the suggested provision appears to be too vague and indefinite to give meaningful guidance to either the state legislators or the courts that will be interpreting it. In particular, we are wary of anything that might be interpreted as authorizing, if only by implication, state legislation which might substantially delay, deter or impede tender offers. Any such state legislation would be particularly unnecessary if the extended minimum offering period provided for in the Bill is adopted, and if the prohibitions against abusive acquisition tactics such as creeping tender offers and street sweeps are enacted.

The CHAIRMAN. Thank you very much, Mr. Martin.

Our final witness is Ms. Margaret Cox Sullivan, president of Stockholders of America.

Ms. Sullivan, we are honored and delighted to have you. Go right ahead.

STATEMENT OF MARGARET COX SULLIVAN, PRESIDENT, STOCKHOLDERS OF AMERICA, INC., WASHINGTON, DC

Ms. SULLIVAN. Thank you very much.

Stockholders of America is a nonprofit and a nonpartisan national membership organization of stockholders. We were established in 1972. We are pleased to have the opportunity, and I might say, the privilege to appear before this committee today.

We support and we applaud the effort of you, the chairman, and the members to have devoted this time to curb the hostile corporate takeovers and the insider trading abuses which, as Professor Peter Drucker has stated, have "already profoundly altered the contours and the landmarks of the American economy."

One of the purposes in establishing our organization 15 years ago was to improve public understanding of the role that individual stockholders play in our capitalistic system—free enterprise—and the vital function the security markets perform in stimulating and sustaining a healthy and prosperous economy. And our markets have been recognized as the most effective, open and fair auction markets in the world; however, 1 year ago, Felix Rohatyn said:

> The integrity of our securities market and the soundness of our financial system are vital national assets which are being eroded today.

Former Justice Arthur Goldberg said:

> The need for public airing of the takeover game is even more evident than in the 1930's. Credibility is the touchstone of our capital markets.

And keeping the credibility of our capital markets and the confidence is of paramount concern to individual investors, our members of Stockholders of America.

Our members come from all walks of life across the Nation. They are the suppliers of services, they are the factory workers, they are the office employees, pensioners, retirees, school teachers, librarians, barbers, and on and on, making up the very tapestry of America.

We are aware of all of the so-called "little guys," who are the savers, investors and the role they filled in building this great industrial country and the part they are expected to continue to play in the current times and future years. And their views should be listened to.

They have been called the backbone of the system, you know.

A recent Harris Poll commissioned by the Institute of Private Enterprise at the University of North Carolina brought out some very interesting and revealing facts and figures, and I will use a few to corroborate my statement.

A hostile takeover was defined as one where the management of the company and its board of directors do not want to be taken over by the group offering to buy it. The survey revealed a substantial 58 percent of the American people feel that such hostile takeovers do more harm than good. Among individual stockholders, a 60 to 36 percent feels the same way.

A big majority of the public agrees that "most hostile takeovers are engineered by groups of big investors who are trying to drive up the price of the stock just to make a profit for themselves."

I found it quite engaging that a large percentage believed that the hostile takeovers were engineered by groups of big investors, and that is why it is. And that is just the way it is.

You know, the American people are smarter than we think. The groups that the people referred to are a well-thought-out coalition of raiders, arbitrageurs, investors, investment bankers, lawyers, banks and other lending institutions. It is quite a group.

You have a winning formula for faster, bigger, and surer profits than normal, when you combine the ability to pay a premium, the manipulation that puts a company in play and the coercive aspect that makes it highly unlikely it will stay independent and in one piece.

It is axiomatic in the takeover business that once a company is "in play," the odds of remaining independent are small. Perhaps one to five.

All that is needed to put a company "in play" is to initiate enough buying to start the stock moving up and to accompany this with rumors or an announcement that a takeover is under way. It has been likened to the 1920's pools. Today's raiders have the same sort of power to make or break stocks and, seemingly, to guarantee themselves profits, sometimes at the expense of small investors.

And of course, the manipulative aspects of hostile takeovers are the very antithesis of our free enterprise system.

The only benefit of hostile takeovers that is not contested is, the stockholders of the target company do make money, since the premiums paid in these takeovers range anywhere from 40 to 50 and sometimes 80 to 100 above the market.

Now according to Dr. Warren Law, though, and he stated this:

> Stockholders in target companies gain greatly from takeovers, but the record of their counterparts on the acquiring side is less distinct.

And you know, for every winner, there's a loser.

Since the time is short, and you have all been here an awful long time, I think I am going to just kind of close this up, you know? I had so many wonderful things to say here, and they are really scary, but I really feel for you all. So I am going to say this:

WILLIAMS ACT SHOULD BE UPDATED

I think if you take the profit out of all this skullduggery, you'll stop it in its tracks. You know, when they asked Willie Sutton, why he robbed banks, he said "That's where the money is." Well, the Williams Act must be updated. In adopting the Williams Act of 1968, Congress sought to establish an evenhanded regulatory structure between the bidders and the targeted companies; however, takeovers in the 1960's were conglomerate mergers, which were driven largely by long-term considerations, the belief that mergers and acquisitions produce better-managed companies and opportunities for growth.

And that was all to the good. But that is not the case today. These takeovers are not for the purpose of diversification, expansion or growth, but are financial transactions for the profit of the takeover entrepreneurs. The entrepreneurs that Mr. Lipton referred to are the raiders, the arbitrageurs, the investment bankers who play the game in concert. That is the group that people in the Harris Poll named as making a profit for themselves.

Corporate raiders can now acquire large blocks of a target company's stock with virtually no risk and with virtual guarantee of substantial profits.

I am going to go right now to just what we want to do. All of this group's activity, all of their working together and all of their talk and their manipulation, no match for the individual investors. They can't play this game. They are just not equipped to do it, they're not sophisticated enough. And even though there are 47 million stockholders in America and now an equal number of men and women, they are investors, not speculators. They are individual investors. They make individual investments. Our surveys reveal their investments are made, for the most part, on individual decisions.

And I said at the beginning of my statement, they come from all walks of life, and when a debt-financed hostile takeover causes plant closings and job lay-offs, those lives are hurt. And there are many examples of entire communities becoming ghost towns. If the communities are not completely ghosted, they are, at best, devastated. There is a reduction of the tax base in these communities, lowering of funding for the public school system, the police, the fire protection and other community services, and the charitable contributions are not forthcoming, and many good, good organizations which need support are not there. The support is not there.

Stockholders of America applauds and supports the legislation before this committee, which would reform the Williams Act, and support, in principle, the changing of the disclosure requirements in embraced in the Tender Offer and Disclosure and Fairness Act, the Tender Offer Reform Act and the Corporate Takeover and Insider Abuse Reform Act.

The individual stockholders need all the information that is available to the more sophisticated groups that we have discussed, and they need them to make their own individual thoughtful business judgments. Rather than debating and comparing every measure in those three bills, we want to state that we support Senator Proxmire's and Senator Riegle's S. 1323 bill, with two additions.

We believe that the requirement of financing of takeovers be in place before the tender offer is commenced, as included in Senator Sanford's bill, S. 1235, is very fundamental, and we support it.

We also support the provision in S. 1234 designed to take the profit out of the manipulative takeovers where the bidder has no intention of going forward with a tender offer and prohibits short-swing profits by providing that any person who commences a tender offer must return to the issuer all profits, less reasonable expenses, made on the securities within the 6-month period after the tender offer was made, unless the SEC exempts the transaction from such a requirement.

These two provisions will go a long way toward stopping the quick dollars being made by the fast operators.

And again, I want to thank the committee for all the thought and the effort you have devoted to this problem.

[Complete prepared statement of Margaret Cox Sullivan follows:]

TESTIMONY BY JAMES S. MARTIN,
EXECUTIVE VICE-PRESIDENT AND
CHAIRMAN, FINANCE COMMITTEE,
COLLEGE RETIREMENT EQUITIES FUND,
BEFORE THE SENATE BANKING COMMITTEE,
June 25, 1987

We are pleased to be given the opportunity to express our views on the proposed tender offer legislation -- the Tender Offer Disclosure and Fairness Act of 1987 -- which has recently been introduced in the Senate. In April of this year, we were privileged to give testimony on takeover issues before the Antitrust, Monopolies and Business Rights Subcommittee of the Senate Judiciary Committee, and we are delighted to see that many of the abuses in the takeover process that we discussed in that testimony have been addressed in the new legislation.

For those of you who do not already know us, the College Retirement Equities Fund -- or CREF as it is generally known -- is the equity component of the nation's largest private pension system. Together with our affiliated company, Teachers Insurance and Annuity Association -- TIAA -- we invest the pension contributions of about one million employees of U.S. colleges and universities, and related non-profit educational organizations. TIAA-CREF's assets exceed $50 billion, and CREF itself has more than $25 billion invested in the common stocks of 1500 U.S. companies. CREF's equity portfolio is one of the largest in the United States, and we are among the largest shareholders of many American corporations.

As a large shareholder, we take very seriously our right and our responsibility to speak out on matters which affect the value of our investments and the interests of those who have committed their pension contributions to us. We believe that we are in a unique position to speak about issues that concern large and small shareholders alike, since both large and small shareholders share a common interest in long-term corporate welfare. In this regard, we strongly disagree with the accusations that institutional investors are not mindful of the long-term interests of the corporations in which they own securities, and are concerned only with short-term profits. Our experience is just the contrary. Indeed, in CREF's case, most of our portfolio represents investments that we have held for at least five years. We spend a great deal of time trying to assess the earnings potential of our portfolio companies beyond the next quarter or the next year. In general, the evidence shows that institutional ownership has been beneficial to the long-term interests of corporations. For example, companies with large institutional ownership tend to spend more on long-term research and development than other companies.

As we testified previously, we believe that federal legislation is necessary to correct the abuses which have developed on both sides of the takeover process -- both on the side of a corporate raider seeking to put a company "in play" so as to make a quick turnover profit, and a target company management seeking to entrench itself and insulate itself from any offers to acquire the company. Legislation must, however, maintain the neutrality and balance which we believe is essential to protect large and small shareholders alike, and we believe that, for the most part, the legislation which has been proposed serves that objective. We continue to believe that the tender offer is largely a beneficial transaction for shareholders -- one that has brought far more good than harm to this country's shareholders. Legislation in this area should seek to preserve, not destroy, these benefits.

Our views on two of the most notorious takeover abuses -- greenmail and poison pills -- are, we believe, now fairly well known. We have been active for some time in seeking federal legislation against greenmail -- a practice which benefits only corporate raiders and incumbent management seeking to entrench themselves. We fully support the proposed legislation on this subject.

We also find the poison pill to be a particularly troublesome device, and have actively supported legislation to restrict it. Poison pills, in our view, deprive shareholders of their basic right to evaluate for themselves offers for their shares; and -- by deterring offers that might be beneficial to shareholders -- they reduce the value of the company's stock. By the use of poison pills, managements assume an authority that they have never had in the past and should not properly have: to decide who should or should not own the company. Poison pills deprive shareholders -- the owners of the corporation -- of their fundamental right to decide for themselves whether to sell or hold their stock, and who should control their corporation. As stated last year by a Court of Appeals which invalidated a poison pill, "such a device effectively precludes a hostile takeover, and thus allows management to take the shareholders hostage. To buy the company, you must buy out its management." Defensive tactics such as poison pills, said the Court, often leave shareholders "defenseless against their own management."

We would have no objection to an outright prohibition of poison pills, although we are not certain that this is necessary. It would be sufficient, we believe, to require that poison pills be prohibited unless approved by the company's shareholders. But we believe it to be very important that such a requirement cover poison pills that are adopted at any time, and not only those adopted during a tender offer. Limiting the requirement to pills adopted during a tender offer would go only a short way toward correcting this serious abuse, since the great majority of poison pills are adopted before a tender offer is underway, and these pills are just as inhibiting of tender offers, and detrimental to shareholder values, as pills adopted during an offer. Indeed, we believe that there are no legitimate reasons not to require shareholder approval of poison pills enacted prior to any tender offer, particularly since in that situation, the company is not under the time pressures inherent in a tender offer, and there is usually more than sufficient time in which to seek shareholder approval. If the restrictions on poison pills are limited to those adopted during a tender offer, this important abuse of the takeover process -- an abuse which has a fundamental impact on the ownership rights of shareholders -- will go largely uncorrected.

With respect to the so-called "Section 13(d) window," we support the provision in the proposed legislation that would reduce the ten-day filing period to one day. We do not, however, believe that it is necessary to reduce the 5% reporting threshold to 3%, as the bill provides. A lower threshold will, we believe, lead to many unnecessary filings for stock acquisitions which are not related in any way to a possible change in control. A possible alternative could be a lower threshold except for institutional investors who have no intent to seek control.

It also might be unduly rigid to prevent an investor who has indicated an investment intention in its filings from making a tender offer for six months. While there has undoubtedly been substantial abuse in filings which attempt to conceal or obfuscate the investor's intentions, it is possible for intentions legitimately to change, or for there to be a change in circumstances which prompts a legitimate re-evaluation of the investor's plans. It would seem that the courts, in actions brought under Section 13(d), are equipped to police the accuracy of filings made, without imposing a somewhat arbitrary rule that might operate to limit beneficial tender offers.

We strongly favor the provision of the proposed legislation which effectively prohibits "creeping tender offers" and "street sweeps" by requiring that all acquisitions of more than 15% of a corporation's stock be made by means of a tender offer available to all shareholders. We see no useful purpose in the "creeping tender offer" or "street sweep," acquisition techniques which, by their nature, are not available to all shareholders, and primarily benefit only the professional investor or arbitrageur. In fact, we have found that even with our substantial resources, we have been unable to benefit from "street sweep" situations, and the small shareholder is left out in the cold altogether.

We do not, however, think that it is necessary or in the interests of shareholders to ban partial and two-tier offers that are made available to all shareholders, at least in the absence of evidence that these kinds of offers have actually resulted in inequities among different types of shareholders, and we note with approval that the proposed bill does not prohibit these types of offers. The SEC has recently concluded that partial offers serve many legitimate business purposes, and that "there is little evidence that individual shareholders have had difficulty in participating in offers for less than all the shares." The SEC has also concluded that two-tier offers have diminished to such an extent that any problems which they may have previously presented are now minimal. It may well be that two-tier offers have not in fact harmed shareholders as a group because they have provided a substantial premium to shareholders that would not exist if no bid at all had been made or if a bid had been frustrated by the target company.

With respect to the duration of tender offers, we would support the Bill's expansion of the minimum offering period from 20 to 35 business days. We believe that 35 business days is an appropriate compromise between the present 20-day period, and the substantially longer periods which have been suggested by some observers. As we noted earlier, we believe that tender offers generally have been beneficial to shareholders, and we want to see them continue. If legitimate bidders believe that their chances of ultimately acquiring a target company were substantially reduced by requiring a greatly extended period -- because, for example, of the greater time available for the implementation of defensive tactics, tender offers might be substantially deterred in the first instance. The 35-day period should not substantially deter tender offers, and, on the other hand, will give target companies significant additional time in which to maximize shareholder value.

We would certainly support the right of pension fund managers to take into account long-term investment prospects in determining whether to tender their shares; as we previously testified, we believe that we have always taken into account the long-term interests of the corporations in which we have invested the funds entrusted to us.

Stockholders
of America, inc.

INVESTORS
IN
AMERICA

THE VOICE OF 47 MILLION

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STATEMENT BEFORE
COMMITTEE ON BANKING, HOUSING AND
URBAN AFFAIRS

U.S. SENATE

100TH CONGRESS

BY

MARGARET COX SULLIVAN
President
STOCKHOLDERS OF AMERICA, INC.
Washington, DC

June 25, 1987

Mr. Chairman and Members of the Committee:

My name is Margaret Cox Sullivan. I am President of Stockholders of America, a nonprofit, nonpartisan national membership organization of stockholders established in 1972. We are pleased to have the opportunity and the privilege to appear before this Committee today. We support and applaud the efforts of the Chairman and the members have devoted to curb the hostile corporate takeovers and the insider trading abuses which as distinguished Business Professor Peter Drucker has stated, have "already profoundly altered the contours and landmarks of the American economy".

While SOA does not give investment advice or counseling nor do we enter proxy fights or class action suits, or the internal affairs of any corporation; we do have an abiding concern for the issues which affect all stockholders. These issues certainly do. One of the purposes in establishing the organization fifteen years ago was to improve public understanding of the role the individual stockholders play in our capitalistic system - free enterprise - and the vital function the securities markets perform in stimulating and sustaining a healthy and prosperous economy. Our markets have been recognized as the most effective open and fair auction markets in the world. However a year ago Relix Rohatyn said, "The integrity of our securities markets and the soundness of our financial system are vital national assets that are being eroded today". Former Supreme Court Associate Justice Arthur Goldberg stated in an article in the beginning of this year, "The need for public airing of the takeover game is even more evident than in the 30's. The securities markets have undergone profound changes. The growth and impact of the market on our economy are infinitely greater than during the Depression, and abuses, unless corrected, can have an even more far reaching effect. Credibility is the touchstone of our capital markets, as it is of our political system. If the confidence of investors is impaired, a debacle is not impossible".

Keeping the credibility of our capital markets and the confidence of the individual investor is of paramount concern to the individual investors - the members of Stockholders of America. The only requirement for membership is that he or she must own a share of stock. The size of the portfolio is not a criteria nor are the names of the stock of our concern. That indicates that our members come from all walks of life across the nation. They are factory workers, office employees, pensioners, retirees, suppliers of services, school teachers, librarians, barbers, and on and on - making up the very tapestry of America. We are all aware of the so-called "little guys" who are the savers and investors - and the role they filled in building this great industrialized country - and the part they are expected to continue to play in the current times and future years. Their views should be listened to.

A recent Harris Poll commissioned by the Institute of Private Enterprise at the University of North Carolina brought out some very interesting and revealing facts and figures. I wish I could quote the entire study; it is immensely interesting but it is an inch and a half document, so I'll spare you. I'm certain you all have heard a great many numbers since these hearings began - so I will use only a few to corroborate my statement.

A hostile takeover was defined as "one where the management of the company and its board of directors do not want to be taken over by the group offering to buy it".

The survey revealed:
---A substantial 58% of the American people feel that such hostile takeovers do more harm than good, while only 8% say they do more good than harm, and 28% more believe they make little difference as far as the overall economy is concerned. Thus by 58% to 36% the public is opposed to hostile takeover attempts. Among employees, a comparable 59 to 37% majority feels the same way. Among individual stockholders, a 60% - 36% feels the same.

---by 78 - 19%, a big majority of the public agrees with the charge that "most hostile takeovers are engineered by groups of big investors who are trying to drive up the price of the stock just to make a profit for themselves".

I found it quite engaging that a large percentage believed that the hostile takeovers were engineered by groups of big investors, and that's the way it is. The American people - the American stockholders are an informed people, and a people who believe in fair play. The groups that the people referred to are a well thought out coalition of raiders, arbitrageurs, investors, investment bankers, lawyers, banks, and other lending institutions. It's quite a group. You have a winning formula, for faster, bigger and surer profits than normal when you combine the ability to pay a premium, the manipulation that puts a company in play, and the coercive aspect that makes it highly unlikely it will stay independent, and in one piece. It is axiomatic in the takeover business that once a company is "in play" the odds of remaining independent are small. Perhaps one to five.

All that is needed to put a company "in play" is to initiate enough buying to start the stock moving up and to accompany this with rumors or an announcement that a takeover is underway. A "Wall Street Journal" article last November, entitled "Raiders' Activities Revive Memories of 1920's Pools," stated that those involved in the pools " . . . would quietly buy up a big chunk of a company's stock. They would then create a swirl of phony trading that would lift the price like a kite. This would attract small investors, on whom the insiders would quietly unload their stock, and the price would collapse. The current upheaval in U.S. industry stirs memories of these pools. Although there are plenty of differences, today's raiders have the same sort of power to make or break stocks and seemingly to guarantee themselves profits, sometimes at the expense of small investors".

And of course, the manipulative aspects of hostile takeovers are the very antithesis of our free enterprise system.

The only benefit of hostile takeovers that is not contested is that the stockholders of the target company do make money, since the premiums paid in these takeovers range anywhere from 40% to 50% and sometimes up to 80 to 100% above the market. However, according

The CHAIRMAN. Thank you very much, Ms. Sullivan, for another superlative statement. We appreciate the statements of all of you witnesses. They have certainly been first class.

Every one of these four witnesses represents a very large number of shareholders. You speak for many people. And yet, you are all outsiders.

You aren't insiders. It seems that in every case, you suffer from manipulations by insiders, whether they are raiders or arbitrageurs or others who come in and have information that you don't have. They buy stock that you don't know about. And on the way down, they sell stock. You don't know the reason they are selling it. Maybe they are aborting a raid. So that it seems that in the case of all of you are hurt and hurt badly by the kind of manipulation that we suffer from corporate raiders moving in fast, having inside information that you don't have.

Mr. Martin, you pointed out that you do control billions of dollars. Would you agree that you are an outsider, in the sense I have tried to describe it?

Mr. MARTIN. Well, we certainly have no evidence we have ever been able to profit by the actions of the kinds of people we are talking about. Senator Metzenbaum asked, at one point, whether we could quantify any of the damage that had ever been done to the participants in the CREF fund, and we have a great deal of difficulty of doing that. Greenmail happened to be one area in which we could take a shot at it, and we estimated that just in the last year or so, CREF participants suffered a loss of $20 million because of the payment of greenmail, and that is computed just simply looking at the market value of the stock on the day before greenmail is paid and the market value of the next day.

That is that kind of computation. So it has been a pretty serious loss. So that is of the reasons we feel, I think, as strongly about greenmail.

The CHAIRMAN. Now you say on page 2, that for the most part, the legislation which has been proposed serves that objective.

Does that mean you support the Proxmire/Riegle bill and the Sanford bills, as Ms. Sullivan indicated so beautifully?

Mr. MARTIN. We addressed what reservations we have, but we can certainly support the bill, Senator, yes.

The CHAIRMAN. Very good.

Ms. Sullivan, you would make two additions to the Proxmire bill that Senator Sanford has proposed. One of them, supported by the National Association of Manufacturers, provides that a group that commences a tender offer must return to the issuer all profits made on securities within a 6-month period after the tender offer was made.

I have that view too. I am just concerned with whether 6 months is the right period or whether it should be a longer period.

Ms. SULLIVAN. It is difficult, and I am not really smart enough to say if it is a 6-month thing, but that was in the bill, and I thought it was so good, and it must have been thought through, that I thought we should support it.

The CHAIRMAN. Very good.

Now, Mr. Goldin, two aspects of the proposed legislation that trouble you. One is your definition of a group of investors.

We are concerned about that too. We would like some help on your part. We would like to tighten it up some.

Can you suggest how you would do that?

DEFINITION OF A GROUP OF INVESTORS

Mr. GOLDIN. Well, the proposed language in the bill, Senator, that reads "or influencing the management or policies of an issue," is excessively broad, because, as I indicated, it can be read to comprehend the activities of groups like the Council of Institutional Investors, which come together, essentially, to inform themselves, in which the members preserve their prerogative to act independently, but in which, as the result of their achieving the same information level, may, in the end, albeit it independently, act in the same way.

The CHAIRMAN. Well, I think that is a very good suggestion. We didn't intend to include a group of that kind.

Mr. GOLDIN. And I would suggest, therefore, that that is the phrase that needs to be dealt with. The phrase "or influencing the management or policies of an issuer." I would be glad to consider what appropriate phrasing might be substituted or how that might be changed, but I would urge that you and the staff, the members of the committee, focus on that language. It is potentially dangerous.

The CHAIRMAN. That would be very helpful. If you could drop us a note indicating any way you would like to—you think it would serve the public interest, let us know.

Mr. GOLDIN. Yes, sir.

[Information requested may be found in additional material.]

The CHAIRMAN. Now the second point is that a definition of arbitrageurs, should exclude public pension funds as it does ERISA funds.

Mr. GOLDIN. Yes, sir.

The CHAIRMAN. Could you give us a little more on that?

Mr. GOLDIN. I have the feeling, and I am speculating at this point, that the omission of public pension funds from the exemption which the proposed bill would grant to ERISA funds may have been inadvertent, because the very same reasoning, the very same rationale that would warrant an exemption for ERISA funds would seem to apply no less, would seem to apply, indeed, equally, to public pension funds, and therefore, we would urge that the same exemption be provided.

The CHAIRMAN. Fine.

Mr. GOLDIN. Senator, if you will permit me, I am going to ask if I can be allowed to respond very briefly to a point that you made in questioning Mr. Martin. You asked whether he considered himself an outsider, in the sense that you defined it, and he said he did, as do I, but I would respectfully say that I am not certain that I agree with the conclusion that you drew from that, and I wouldn't want my silence on that matter to be interpreted as concurrence.

We are outsiders, in the sense that you describe it. And indeed, the fact that we are outsiders, leaves us to seek tightening of legislation and regulation that would prevent the unwarranted use of nonpublic information, and your description of the consequence that flows from our being an outsider focused on unwarranted use of nonpublic information. And we share your view that there ought to be greater attention paid that, both administratively and potentially, legislatively. But we would not necessarily agree that the fact that we are outsiders ought to lead us to conclude that there should be the kind of wholesale restriction on the potential for corporate takeovers that some are proposing.

PURPOSE OF LEGISLATION IS TO PREVENT ABUSE

The CHAIRMAN. I think that almost everybody who has testified here has indicated that they recognize that there is a very constructive place for takeovers, including hostile takeovers. They can serve a good purpose. But we think that there has been abuse and the whole purpose of the legislation is to prevent that abuse. Senator Sanford.

Senator SANFORD. I agree with the chairman that we must legislate against current abuses. Specifically, the tremendous amount of debt financing in hostile takeovers must be monitored. We are simply trying to restore the orderly operation of the market by curtailing certain disorderly practices. While I don't believe that all hostile takeovers are generally good. I think hostile takeovers have to be bad where they are bought without any money, solely financed by the assets of the takeover target.

So I like very much what Ms. Sullivan said. In fact, I could have listened to you right on through lunch. [Laughter.]

I think you're after those rascals the way we ought to get after them. [Laughter.]

Let me ask Mr. Martin—he's got whatever little money I've got in pensions in his care.

Mr. MARTIN. We're keenly aware of that, Senator.

Senator SANFORD. Where do you think greenmail came from? Why do we have greenmail?

Mr. MARTIN. Well, I think the reason—greenmail is a device that has been used by management, for management's benefit. That's our view of it. We think it's strictly used by management.

Senator SANFORD. That's not my question. I said, why did it arise?

Mr. MARTIN. It arose, because managements were threatened with replacement by new shareholders, new management. Those management——

Senator SANFORD. No, I don't agree with you. We didn't even hear of greenmail until a few years ago. Because of the hostile takeover that comes in without any money of their own, they have devised the procedure in the last few years. This is a defense against a unwarranted attack. And there wouldn't be any greenmail if there wasn't a hostile takeover that is unsupported by money. We never had any problems with hostile takeovers, when you had to spend your own money to take over the corporation. We never had any problems of hostile takeovers when you had to have a proxy fight. It is only recently, with the junk bond, the bridge financing, the no-risk attack on a company, that we had this kind of business. So there wouldn't be any greenmail, if we could get at the improper kind of hostile takeovers, would there?

Mr. **Martin**. Not all greenmail has been paid in a situation in which financing of that type was contemplated.

Senator **Sanford**. Well, name one. I have been unable to find one.

Mr. **Martin**. That was going to be financed——

Senator **Sanford**. That was not a result of a——

Mr. **Martin**. We do have a situation now in which margin requirements do apply.

Senator **Sanford**. Well, greenmail is a product of what we are trying to get at, is my point. And I am satisfied to let you keep my money a little bit longer. [Laughter.]

Mr. **Martin**. I appreciate your vote of confidence.

ARE INSTITUTIONAL INVESTORS PART OF THE PROBLEM?

Senator **Sanford**. Let me turn to you Mr. Goldin and Mr. Sweeney. You know, a great many people think that institutional investors just don't care about anything but the fast dollar. That is the reputation you are getting; sell the stock at the highest dollar and run. A great many people think that you are part of the reason that this kind of hostile takeover business has been able to flourish, that you don't really have any care for anything beyond the price of the stock. And you don't really care about the communities. And you really don't care about the corporate structure of America, as long as you can make a quick dollar. And you really don't care about the 80,000 union labor members who lost their jobs because of break ups resulting in these kind of improper hostile takeovers.

I want you to tell me that's not so.

Mr. **Goldin**. Well, I am glad to tell you that, Senator, and I can substantiate the assertion by reminding, not you, because you understand, but others who make that claim, that when you deal with asset pools of our size, and they are increasing, we are inevitably and necessarily investors in the American economy.

While it is true that we must make individual stock selections, we are captive to the broad range of public companies that are available for us to invest in. We can't pick up our marbles and leave. As a result, our interest, our focus is in the long-term health of the American economy and the long-term health of corporations and the long-term viability of our investments. We deal with a conundrum. We deal with a difficult set of competing equities.

On the one hand, we have this long-term interest in the economy and in the health of our investments, generally.

On the other hand, we recognize that if management is entrenched, if management knows that it is insulated from accountability, that it has avoided the potential of being displaced.

This is something that we understand particularly well, as elected public officials. The result can be disastrous for the company, for its owners and for the public interest. And therefore, management must know that there is a real potential, if it does not perform properly, that there can be an effective challenge to it.

That is the reason that we take the position that it would be a mistake to rule out the potential for hostile takeovers.

Senator **Sanford**. Well, in the past you had other ways of making a change in management that were fairer propositions. You had the proxy fight, which was a legitimate way to change management, but the hostile takeover is different. Do you own any Burlington stock, for example—Burlington Industries?

Mr. **Goldin**. I rather imagine we do. I don't know, specifically, but I am certain we must.

Senator **Sanford**. Well, you stand to make a quick buck there, but you know where that quick buck comes from?

Mr. **Goldin**. Well, Senator, I can't tell you, necessarily, that in every tender case, where we are offered a premium, we are necessarily going to tender our shares. We often hang onto our shares, if we think that there is greater potential to maximize the value of assets. And the presumption that every time we are offered an extra dollar or two, every time another couple of dollars is dangled in front of our noses, that we seize it and run, mistakenly assumes that we don't make an independent evaluation of what our long-term interest is, potentially, in remaining in that company.

Senator **Sanford**. Thank you. I am glad to have that in the record, and I appreciate it.

May I ask Mr. Sweeney just one more question?

The **Chairman**. I am through. Go right ahead.

Senator **Sanford**. You know, we have done fairly well in this country leaving corporate governance to the States, and despite the fact that I am now here, I never did think all wisdom resided in Washington. I have great confidence in the States to handle their own corporate law.

I have always been a bit displeased that so many lawyers wanted to incorporate corporations in Delaware, which gave us a kind of national corporate law, but not necessarily of the kind that suited the various regions and varying conditions of the country.

You surely aren't in favor of putting all corporate law under national mandate, are you?

Mr. **Sweeney**. No, Senator. If I could answer your first question you posed to Mr. Goldin. Then I will proceed to the second one.

Your first question, perhaps was of even more interest to myself, in that I truly represent 170,000 members of the Sheet Metal Workers International Association. And in that capacity, I have a short paragraph on page 5 of my formal statement, which I would just like to read into the record.

With respect to the question of institutional investors being short-term, quick-buck players.

I noted that as SEC in a 1985 study on institutional ownership clearly refuted the short-term argument by establishing that institutional investors invest in companies with long-term research and development plans. We look for successful companies, effective management, in which to invest our funds; however, we also believe that the restructuring of corporate America should be encouraged whenever necessary to cut costs and produce more effective companies which are able to respond to competitive challengers, and—I should emphasize—thereby preserve and hopeful expand job opportunities for American workers. An expanding job force, not quick profits, is the absolute key to the future of public and private pension plan programs.

With respect to your second question, Senator, on the issue of preemption, on that particular issue, I draw upon, perhaps my own personal experience in the area of ERISA and the governance of pension plans. And it has been my experience, Senator, as a litigator in the ERISA area, that the beneficiary, the person for whom we all perform these functions that we do, receives much greater protection in the Federal forum than in the State forum.

Now I would agree with you that I would not like to see all regulation in the Federal forum. I think that the reverse preemption set forth in the proposed Senate bill would act adversely to the small shareholder.

Senator **Sanford**. Thank you.

And if I may just make one other comment. My objection, primarily, to hostile takeovers, is that no money, no real money of the people who are attempting to make the purchase is at risk. They do it with debt, and we end with a debt-ridden company. True, the stockholders have made a profit, but you make the point that we need companies that have money for research. And Burlington is a good example. They now will be heavily in debt. They were on the leading edge of innovation and research in the textile business in the country, and that capacity now has been diminished, if not eliminated, because of this kind of hostile takeover that involves substitution of equity for debt. And that is what we are really trying to get at.

How do you keep from destroying the capacity of companies to be strong companies? It is not a question of entrenching management. It is a question of not abusing the process, and in doing so, damaging the capacity of American companies to compete.

So I think the focus there is on what happens to the company. You've got other ways of getting rid of entrenched management.

Thank you very much. And thank you, Mr. Chairman.

The **Chairman**. Well, thank you folks. You were certainly an excellent panel. We are in your debt. You've made a fine record.

Ms. **Sullivan**. Thank you.

The **Chairman**. The committee will stand in recess.

[Whereupon at 12:40 p.m., the hearing was adjourned.]

[Additional material received for the record follows:]

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July 6, 1987

Senator William Proxmire
Chairman, Committee on Banking,
Housing and Urban Affairs
U. S. Senate
Room 534
Senator Dirksen Building
Washington, D. C. 20510

Dear Mr. Chairman:

The attached is being submitted for filing in the record as part of the hearings you are holding on S. 1323.

We appreciate the opportunity to comment on the proposed legislation. Should you have any additional questions, we would be happy to respond.

Sincerely,

W. G. Binns, Jr.

W. Gordon Binns, Jr.
Chairman
Committee on Investment of Employee Benefit Assets

Attachment

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STATEMENT

Prepared in connection with S. 1323 for submission to the Committee on Banking, Housing, and Urban Affairs of the Senate of the United States on behalf of the Committee on Investment of Employee Benefit Assets of the Financial Executives Institute, July 6, 1987.

These observations are presented by the Committee on Investment of Employee Benefit Assets (CIEBA), which is a committee of the Financial Executives Institute (FEI). The FEI membership comprises 13,000 financial executives representing 6,000 of the leading corporations in America. CIEBA itself has approximately 40 FEI members as well as more than 100 advisory members, with each group of members drawn from private corporate plan sponsors all governed by ERISA and covering a broad base of industries. The employee benefit assets of the companies involved with CIEBA total considerably in excess of $300 billion.

CIEBA was formed in November 1985, with the purpose of serving as a body of information and expertise, and to help develop positions on public policy issues related to the investment of employee benefit plan assets. Committee members, it is important to note however, speak from the vantage point of those charged with fiduciary responsibilities under ERISA and do not, therefore, necessarily represent the views of their companies.

The Committee's comments on specific sections of the proposed legislation follow.

to Dr. Warren Law, Professor of Banking Finance at the Harvard Business School, says "Stockholders in target companies gain greatly from takeovers, but the record of their counterparts on the acquiring side is less distinct. A recent study of 78 mergers and takeovers in the years 1976 through 1981 concluded that three years later, the price of the acquirer's stock was much lower than if it had continued to perform as it had before the acquisition."

There are many reasons why the raiders can afford to pay a premium above market value for a company. Peter Drucker in the same article which was quoted earlier pointed out, "In any inflation, the cost of capital goods tends to rise much faster than the price of the goods they produce. It thus becomes economical to buy already existing capital assets rather than to invest in new facilities and new machines." It must be noted here that in 1986, for the first time in the history of this country, more money was spent on mergers and acquisitions ($177 billion) than is reliably estimated to have been spent on all of the plant and equipment purchased by all of the manufacturing companies throughout the United States ($140 billion). Mr. Drucker also said "The stock market values companies on the basis of their earnings. It values them, in other words, as 'going concerns.' It does not value them on their liquidation value." This means money can be made by buying a company and then selling off the pieces.

The argument that hostile takeovers displace ineffective managements has received far more importance as a justification for hostile takeovers than it deserves. It is the exception, not the rule. Louis Lowenstein of the Columbia Law School says, "When I looked at all the industrial company targets of hostile takeover in 1981, I found that they had an average return on equity, over a four-year period, of about 16%. Not bad." Lee Iacocca said in an excellent article, "Stopping The Corporate Raiders:" -- "The typical takeover target isn't a company in trouble. It's

a company with a solid asset base, low debt, consistent profits and a few bucks in the bank to diversify or get it through the next business downturn." Warren Law, whom we quoted earlier said "There is no proof that target companies are mismanaged". John Galbraith, when asked "What about the raiders' contention that they are contributing to greater economic efficiency by shaking up complacent and entrenched management?," replied "There is absolutely no evidence of that."

There is considerable evidence that hostile takeovers--contrary to what's claimed--have a significant adverse effect on the productivity and competitiveness of American companies and on the American economy.

And whatever hurts the American companies and the American economy hurts the stockholders.

First and foremost, hostile takeovers have contributed to a vast increase in debt. "Business Week," based on Federal Reserve Board data, has estimated that in 1986 alone corporate debt increased by 200 billion, while corporate equity was reduced by a hundred billion. Felix Rohatyn, in a "Time" magazine interview in December 1985, said "At a time when we are trying to strengthen our important industries to make them more competitive, this weakens them by stripping away their equity and replacing it with high cost debt. Ultimately, the entire U.S. economy suffers." When the U.S. economy suffers, stockholders suffer.

A lot of corporate cash flow has to go to serving this debt. And the debt makes companies more vulnerable to any downturn.

Not enough has been said about the all-around negative effect raids have on the corporations, leaving them in a morass of enormous bank indebtedness with interest rates, servicing junk bonds, and very possibly green mail payments. The increase in the debt/equity ratio is truly alarming. American corporations, in 1986, sold 263 billion dollars worth of debt, which was double the 1985 figure and five times more than the corresponding figure as recently as 1982. Things are really out of hand.

And that's why we are grateful to be here, to support the legislation being considered by this distinguished committee.

If you take the profit out of this skulduggery you'll stop it in its tracks. You know when they asked Willie Sutton, why he robbed banks, he said, "That's where the money is". The Williams Act should be updated. In adopting the Williams Act of 1968, Congress sought to establish an even-handed regulatory structure between the bidders and targeted companies. Senator Harrison Williams, the sponsor, said, "We have taken extreme care to avoid tipping the scales either in favor of management or in favor of the person making the takeover bids". Takeovers in the 1960's, the conglomerate mergers were driven largely by long-term considerations; the belief that mergers and acquisitions produced better managed companies and opportunities for growth. And that was all to the good. But this is not the case today.

Martin Lipton,a leading takeover specialist stated in 1985 "during the past three years there has been a sharp growth in highly leveraged takeovers by entrepreneurs who are not interested in operating the target companies, but seek the opportunity through greenmail, bust-up liquidation of the target,or forcing a white knight transaction that usually also results in bust-up or liquidation of the target. These takeovers are not for the purpose of diversification, expansion or growth, but are financial transactions for the profit of the takeover entrepreneurs". The entrepreneurs that Mr. Lipton referred to are the raiders, the arbitrageurs and the investment bankers who play the game in concert -- that's the group the people in the Harris Poll named as making a profit for themselves.

Corporate raiders can now acquire large blocks of a target company's stock with virtually no risk and with a virtual guarantee of substantial profits. One of the raiders, Carl Icahn, wrote in a 1980 memorandum to potential partners - it was obtained by the American Lawyer:

"It is our opinion that the elements in today's economic environment have combined in a unique way to create large profit-making opportunities with relatively little risk . . . It is our contention that sizable profits can be earned by taking large positions in 'under valued' stocks and then attempting to control the destinies of the companies in question by:

A. trying to convince management to liquidate or sell the company to a 'white knight'

B. waging a proxy contest or

C. making a tender offer and/or

D. selling back our position to the company".

The investment bankers earn such huge fees that they are no longer advisors; they are key players in the game. It is common for investment bankers to earn fees in the tens of millions of dollars as a playmaker in one game.
When fees of this magnitude are involved it is not surprising that the investment bankers actively encourage takeover bids and actively seek to put companies "in play".

And then there is the role of the arbitrageurs. Billions of dollars of investor capital have flooded into the hands of these professional short-term speculators because of their record of earning enormous profits by playing this takeover game. They buy the stock of takeover targets in the hope of reselling it at a high price in a tender off or other takeover transactions. Estimates of the funds managed by the arbs have been placed in the neighborhood of between $10 and $15 billion. Because these funds are not invested on a long term basis, but are shifted from one takeover situation to another, they can control the outcome of virtually any takeover fight.

The investment bankers claim that their arbitrage units' trading for the"firms accounts" are walled off from client information - the so-called "chinese wall" argument. But it now appears that some firms simply swapped their clients' takeover secrets with other firms to bypass each firm's "wall".

Then there the institutional investors who are intensely interested onlookers. Since 1968 there has been a dramatic increase in the amount of corporate stock controlled by institutional investors such as pension funds, mutual funds and other money managers. It is estimated that over 50% of the shares listed on the New York Stock Exchange and over 40% of the shares traded in the over the counter market are now controlled by institutional investors. These investment managers keep their clients happy by continually besting or at least matching their competitors' investment records, forcing them to maximize their returns over the short term. It is recognized that "institutional investors generally are much more eager to sell shares to a hostile bidder (at a premium over posted market price) rather than wait for a future increase in value of a company's shares that may result from long term investments by corporate managers". Actually when a takeover bid is announced, the institutional investors seeking to lock in an increased price for their stock without risking that the takeover bid might fail, often sell their substantial blocks of target company to the arbitrageurs.

All this is no match for the individual investors--they can't play in this game.

Even though they are 47 million stockholders in America -- and now an equal number of men and women -- they are investors. Not speculators. They are individual investors-- they make individual investments and our surveys reveal their investments are made for the most part on individual decisions. As I said at the beginning of my statement they come from all walks of life. They are factory workers, office employees, pensioners, retirees, suppliers of services, school teachers, librarians and on and on and when a debt financed hostile takeover causes plant closings and job lay offs those lives are hurt. There are many examples of entire communities becoming ghost towns If the communities are not

completely ghosted they are at best devastated. There is a reduction of the tax base in these communities lowering the funding for the public school system, the police and fire protection and other community services. Charitable contributions are not forthcoming for the Red Cross,the United Givers Fund and the many other worthwhile organizations and activities which are deserving of support.

Stockholders of America applauds and supports the legislation before this committee which would reform the Williams Act and support in principle the changing of the disclosure requirements as embraced in the Tender Offer Disclosure and Fairness Act (S-1323), the Tender Offer Reform Act (S-227), and the Corporate Takeover and Insider Abuse Reform Act (S-1324).

The individual stockholders need all the information available to the more sophisticated groups we've discussed and they need time to make their individual, thoughtful, business judgments. Rather than debating and comparing each and every measure in the bills, we want to state we support Senator Proxmire's and Senator Riegle's S-1323 bill with two additions. We believe that the requirement of financing of takeovers be in place before the tender offer is commenced as included in Senator Sanford's bill (S-1324) is very fundamental and we support it. We also support the provision in S-1324 designed to take the profit out of manipulative takeovers where the bidder has no intention of going forward with the tender offer and prohibits short swing profits by providing that any person who commences a tender offer must return to the issuer all profits (less reasonable expenses) made on the securities within the six month period after the tender offer was made, unless the SEC exempts the transaction from such a requirement.

These two provisions will go a long way towards stopping the quick dollars being made by the fast operators.

Again I want to thank the Committee for all the thought and effort you have devoted to this problem.

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Sections 3, 4 and 5

We recommend that pension funds and other employee benefit funds be exempted from the requirements of the proposed legislation which apply to lowering the disclosure threshold, reducing the filing period, adopting standstill provisions, expanding required disclosures and tightening the definition of a group required to make 13(d) disclosures.* Three reasons underlie the Committee's recommendation.

First, by its very nature, the purchase of stock of a company by pension and other employee benefit funds is generally for investment purposes only; such funds typically do not seek to control a corporation. Thus, the concerns which the disclosure and standstill provisions address are usually absent in transactions undertaken on behalf of benefit plan funds.

In addition, it is not unusual for large pension funds to find themselves owning more than 3% of a company's outstanding shares, particularly a "non-S&P" company, even though they have no intention to control the company involved. Consequently the proposed disclosures would impose significant reporting requirements on benefit plan sponsors without materially contributing to achieving the bill's stated goal to foreclose the opportunities for abuse which may be part of the corporate acquisition process.

Finally, many pension funds will find it in practice impossible to comply with the proposed requirement that such filings be completed "not later than the close of the next trading day...". While we understand the legislation's interest in reducing the reporting period from 10 days, we feel the 24-

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* This exemption would, as is currently the case, not apply in those instances in which a pension fund is participating in a takeover attempt.

hour reporting requirement would be too stringent for multi-manager pension funds.

In those cases where pension funds retain a number of different investment firms to manage a portion of their assets, the managers make stock purchase decisions independently of each other and, as a consequence, may collectively, in any given day, bring a fund's ownership of a certain company beyond a critical threshold without the sponsor being aware that the threshold has been exceeded. To aggregate and calculate new equity ownership positions daily would call for substantial and costly additional administrative procedures on the part of multi-manager pension funds, again without advancing the bill's purpose.

To summarize: Since pension funds transact stock sales and purchases for purposes of investment and not control, and since larger pension funds can be expected to exceed the proposed 3% threshold of outstanding shares in the normal course of business, and finally since the daily tabulation and analysis of equity ownership positions exceeds the administrative capability of the typical multi-manager pension fund, we recommend that in the event the proposed legislation is adopted, pension and similar employee benefit funds which operate for investment purposes only be exempted from the proposed requirements.

Section 8

CIEBA strongly supports the proposal in the "Tender Offer Disclosure and Fairness Act of 1987" to limit paying a premium to repurchase shares from dissident shareholders unless specifically approved by the other shareholders or unless made in an offer to all shareholders. We believe that the proposal would be beneficial to the participants and beneficiaries of employee benefit plans as it would limit a practice which has been inimical to their interests in certain situations in the past when monies belonging to corporations in which ERISA funds are major investors have been used to make to certain stockholders premium payments in which the ERISA stockholders have not shared.

With regards to the matter of poison pills, the Committee wishes to recall the conclusions it reached in its February 27, 1987 letter to the Securities and Exchange Commission when commenting on the latter's Concept Release on Takeovers and Contests for Corporate Control:

> Most members of the Committee on Investment of Employee Benefit Assets believe that state law is the proper forum for addressing "poison pills," that it has adequately addressed it in the past, and that there is no need for federal intervention into the process.
>
> A substantial majority of Committee members thought that "poison pills" should be voted by shareholders, although a significant minority thought that this step was not necessary.*

Section 9

CIEBA has no objections to these provisions for registration and regulation of tender offer arbitrageurs. We want, however, to maintain the proposed exemption for ERISA governed employee benefit plans if enacted.

Section 10

Our Committee has concluded that Section 10 of S. 1323 should be deleted from this legislation. We understand why the proposals have been put forward and agree that the practices which they intend to discourage, two-tiered tender offers for example, are better eliminated from the corporate takeover process. We share with others the opinion that sometimes takeover tactics run counter to the best interests of the capital markets, the economy, share owners, and pension plan participants. The amendments to ERISA, however, as proposed in this legislation, in our view do not represent the best approach to remedying the situation. Our reasoning behind this conclusion is as follows.

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* W. Gordon Binns, Jr., Chairman, Committee on Investment of Employee Benefit Assets, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission. February 27, 1987. Enclosure, p. 5.

We put CIEBA's position on the record as to what constitutes the required response by an ERISA plan fiduciary to a tender offer when we presented testimony before the Wirth Subcommittee on Telecommunications, Consumer Protection, and Finance in the U.S. House of Representatives on March 19, 1986. Since our comments at that time still hold and are directly applicable to the issue of fiduciary duties and tender offers as raised in the present legislation, we will quote verbatim from our earlier testimony.

> Q: Do the fiduciary responsibilities of plan managers require that they tender shares in virtually any tender offer in which a significant premium is offered?
>
> A: No. There may well be instances when the investment manager determines that, in the long run, the interests of the plan participants and beneficiaries are best served by not tendering shares, even though a significant premium is offered. In such a situation, the fiduciary responsibility of the investment manager is to not tender the shares.
>
> It is generally agreed that different investment managers may buy or sell the same stock for entirely different reasons. For example, a manager may purchase a stock based on a judgment that the company is a takeover candidate and therefore the purchase of its stock would be appropriate as a short-term investment for the portfolio he manages (i.e., the stock should be bought and then sold immediately upon receiving a satisfactory takeover bid). Another manager may have purchased stock in the same company based on the perceived long-term value of the company's assets and thus may decide that existing management will add more value to the assets over the long-term than would be obtained by taking the current cash value for the stock. Investment managers are hired for their expertise in making these types of decisions, which require a balancing of short- and long-term financial and economic interests in order to evaluate the

trade-off between a certain present value and a less certain future value.[*]

As this testimony shows, in CIEBA's view, ERISA as it is currently written permits a fiduciary to choose either way when confronted with a tender offer, to choose to tender or not to tender; further clarification is not required.

The Committee goes further in its analysis, however, to conclude that rather than clarifying ERISA, the amendment as proposed has the effect of introducing a standard for the decision not to tender which is different from and less stringent than the standard against which a decision to tender would be assessed. It is the Committee's understanding that a decision to tender would be held up to the prudent expert standard of ERISA. On the other hand, in the words of S. 1323, a decision not to tender may be taken simply if there is absent a conflict of interest, gross negligence or willful malfeasance, a standard lower than that of the prudent expert and consequently a standard which would introduce a bias in favor of a fiduciary's deciding to reject a tender offer and continue to hold the shares even though such a course might not be in the best interests of plan participants and beneficiaries.

We also recommend against the proposed additions to Section 4044 of ERISA. Section 4044 prescribes how assets of a plan are to be allocated among participants in the case of a plan termination and concludes by specifying the circumstances under which any residual assets may be distributed to the employer. The Section as amended would prohibit residual assets from being used to finance the acquisition of the employing company. We oppose this provision for four reasons.

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[*] Hearing before the Subcommittee on Telecommunications, Consumer Protection, and Finance of the Committee on Energy and Commerce, U.S. House of Representatives, Ninety-ninth Congress, Second Session, on the Impact on Corporate Governance, Trading Activity, and Beneficiaries, March 19, 1986, p. 16-17.

First, as a general principal, CIEBA is opposed to blanket limitations on reversions, such as the one proposed here, because they would affect reversions to responsible as well as to irresponsible employers.

Second, the prohibition on reversions would tend to discourage funding of existing defined benefit plans and establishing new ones.

Third, we believe the concerns about ensuring the security of benefits for participants and beneficiaries in the event of reversion which may have motivated this proposal are being addressed elsewhere, especially in the Administration's proposal on the funding and termination of defined benefit pension plans.

Finally, the prohibition appears to us to be unenforceable. The funds obtained in a reversion are entirely fungible. An employer could use the funds obtained to meet payroll and use the funds formerly allocated to payroll to buy down the debt incurred as part of the takeover initiative. It is hard to see how the use of funds emanating from a reversion could be traced for enforcement purposes.

To summarize: Although CIEBA shares the concerns that have motivated the proposed amendments to ERISA which are found in S. 1323, we nonetheless urge the Committee to delete Section 10 of this legislation. We argue that (1) current law permits a pension fiduciary to choose other than a short term position when confronted with a tender offer, (2) changing the standard for the decision not to tender is ill-advised, and (3) the interests of participants and beneficiaries in the ownership and use of excess pension assets are being adequately dealt with in other legislative forums. We feel, in a capsule, it best not to tamper with current law.

We do suggest, however, that the Committee, if it excises Section 10 as we propose, make its understanding part of the formal record that nothing in ERISA in its current form prevents a pension fiduciary from rejecting a tender offer where the fiduciary's judgment is that the longer run interest of plan participants is better served by continuing to hold the stock.

Section 11

This section proposes increased penalties for insider trading, perjury and obstruction of justice. CIEBA supports efforts to provide equal access to information. We are not qualified, however, to say what penalties for infractions should be.

GENERAL MILLS, INC. • EXECUTIVE OFFICES • 9200 Wayzata Boulevard • Minneapolis, Minnesota

H. B. ATWATER, JR.
Chairman of the Board
Chief Executive Officer

July 9, 1987

The Honorable William Proxmire
Chairman
Committee on Banking, Housing
and Urban Affairs
SD-534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you again for affording me the opportunity to present the Business Roundtable's views on S.1323. As I stated at the Hearing, the BRT supports the Bill.

In particular, we strongly support the language in S.1323 affirming the traditional role of states in regulating corporate governance, internal affairs and the business judgment rule. I cannot overstate the depth of feeling among corporations, employees, local communities and others as to the importance of this provision.

We also believe that S.1323 properly updates the Williams Act to reflect conditions in today's marketplace. Lowering the 13(d) threshold and closing the window to 3% and 24 hours respectively, requiring disclosure of group contacts, extending the minimum offering period to 35 business days (which makes the disclosure effective), and providing for meaningful enforcement of these disclosure requirements by granting private rights of action are all measures about which the BRT feels a sense of urgency.

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In addition, we support adding language to S.1323 which would prevent the abuse of minority shareholders and other legitimate corporate stakeholders by bidders who acquire or threaten to acquire partial but controlling positions in a company. This provision would require a bidder to make a tender offer for any or all of a company's shares once a control threshold of 15 or 20% was crossed.

S.1323, with the addition of an "any or all" provision, would go a long way toward restoring equilibrium and fairness to the takeover process. In summary, Mr. Chairman, we think S.1323 is a good bill that ought to be passed.

Sincerely,

Bruce Atwater

HBA:dt

CC: Hon. Donald Riegle
Hon. Jake Garn
Hon. Alphonse D'Amato

How's this for a pay scale? Of the 100 highest-paid people on Wall Street, the top person made $125 million. The lowest: $3 million.

Wall Street's Superstars

Reported by: David Carey, Lisa Kaplan, Stephen Kindel, Tani Maher, Deborah Mittel, Margaret Price and Stephen Taub.

FREDERICK ADLER
LEONARD SHAYKIN
Principals
Adler & Shaykin

The friendly acquisitors, they do only leveraged buyouts and other restructurings where they are welcome. Partners since 1983, their deals in 1986 included buyouts of the *Chicago Sun-Times*, Peterson Outdoor Advertising, and Addiction Recovery Corp., which together carried a $285 million price tag. More recently they received a $23.7 million legal settlement fee from Revlon and acquired Joy Manufacturing in a $750 million LBO. Their firm currently has a majority interest in all seven companies it still holds and has access to a $125 million buyout fund, of which $100 million is supplied by outsiders.

Adler (Harvard Law '51) keeps two Park Avenue offices and is also a senior partner at the law firm Reavis & McGrath. He still chairs the executive committee at Data General Corp., an earlier venture capital success, and is a director at the Sloan-Kettering Institute for Cancer Research. He earned approximately $20 million last year, which includes income from Adler & Co., the venture capital firm, and Reavis & McGrath.

As Adler's partner, Shaykin (BA '65, MA '66 and MBA '73, University of Chicago) probably earned $8 million but had no comment. He, too, donates regularly to charitable causes, and is chairman of the *Chicago Sun-Times*.

ARNOLD AMSTER
Partner
Lafer Amster

Amster, 46, who controls between 5% and 10% of the firm that bears his name, is closely allied with General Electric Investment Corp., which owns between 25% and 50%. After working as a trader at Smith Barney, Amster joined forces in 1980 with Barry Lafer, who learned arbitrage from Ivan Boesky and holds about 5% of the company. Other partners: Jack Massey (Hospital Corp. of America, Kentucky Fried Chicken) and Britain's Morgan Grenfell.

In 1986, Lafer Amster had a net capital base of approximately $180 million and some $300 million in loans and notes that it uses to leverage arbitrage deals. Amster's compensation: $108,000 in income and $5 million-plus in capital gains. An avid sailboat racer, Amster says, "If you want to know what I'm like, I'll tell you: I look like Woody Allen and I don't talk pretty." On the walls of the firm's Manhattan office are one-share certificates of stocks in which they lost heavily.

G. CHRIS ANDERSEN
Managing Director
Drexel Burnham Lambert

A creative corporate finance specialist, Andersen, 48, made his reputation in the early 1980s with commodity-linked bonds, tying the Sunshine Mining issue to silver prices. But in late 1984, Andersen shifted into administration when he took charge of Drexel's newly created investment banking group, a unit that seeks out new clients and cultivates existing ones. Sources say Andersen, who maintains four residences, earned between $5 million and $10 million last year. That is all the more remarkable given his lifelong struggle with dyslexia. Andersen compensates by relying on oral communication and a keen memory.

HERBERT BACHELOR
Senior Executive Vice President
Drexel Burnham Lambert

In charge of all investment banking operations at Drexel, Bachelor, 43, led his division to record growth last year as it

GRAHAM
-AND-
DODD

Scott Black of Delphi Management

raised $80.4 billion in public and private markets. Some of the highlights: lead managing $30.9 billion of securities in the corporate public markets, an impressive 132% gain over 1985; underwriting $3.2 billion of convertible debt securities for a 33% total market share; and handling $1.9 billion of initial public offerings.

The Harvard-educated executive began his Wall Street career in 1968 at Shearson Hammill's investment banking unit. He joined Drexel in 1978 as associate director of corporate finance. Known for being quiet and contemplative, Bachelor earned at least $5 million to $6 million last year, sources say.

LUCIEN "TOM" BALDWIN III
Proprietor
Baldwin Commodities

Only 31, Tom Baldwin bumped, gestured and bellowed his way to between $7 million and $10 million in income last year. The single biggest local market maker in the clamorous Treasury-bond futures pit at the Chicago Board of Trade, Baldwin is said to move markets on his own. Flirting with ruin, selling when lesser locals buy, he takes breathtaking positions with elan—sometimes swapping $1 billion worth of contracts a day.

Notwithstanding the attendant risks, this St. Louis-born son of a plumbing-supplies salesman, who began trading at the Chicago Board in 1982 with a stake of under $30,000, has scored hefty gains every year since then.

From Thanksgiving to New Year's, when the pit is quieter, he goes skiing via helicopter in the Rockies.

LEON BLACK
DAVID KAY
Managing Directors
Drexel Burnham Lambert

Financially, it was the best of times, but legally among the worst.

This pair, who joined Drexel in 1977, handled 188 completed M&A transactions in 1986, up from 70 in 1985. Black was the deal maker, while Kay concentrated on administration. Among their deals: Kohlberg Kravis Roberts' $6.2 billion acquisition of Beatrice Cos., Playtex Holdings' $1.2 billion leveraged buyout/divestiture of BCI International Playtex and Texas Air's $605.3 million purchase of Eastern Air Lines. Earnings for Black, who will be 36 in July, were at least $5 million, and for Kay, 57, at least $3 million.

On the legal front, insider trading crimes took their toll on Drexel's M&A unit. Colleague Dennis Levine was arrested in May 1986. In February the unit's former joint head, Martin Siegel, pleaded guilty to two felony counts involving insider trading. Press reports say investigators subpoenaed Black. So far the storm clouds and Street gossip don't appear to be affecting the unit's ability to handle deals.

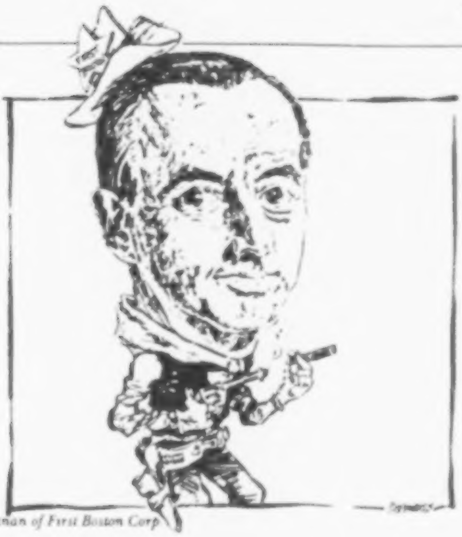
SCOTT BLACK
President
Delphi Management

Did money manager Scott Black merit his $3.5 million to $4 million take? His collection of low p/e stocks rose only 14.9% in 1986, badly lagging behind the indexes. But consider his enviable past: From 1980, when he quit William O'Neil & Co. to form his Boston-based firm, through 1985, Black outshone the market.

That's quite a feat and has made the boyish-looking, Harvard-educated 40-year-old an emergent star of the Graham and Dodd investment school. It also has won him The World Bank and Stanford University as leading clients. Black, who presides over $625 million in institutions' assets, collects 19th-century French art, contributes money to antidrug programs for Boston ghetto children and is a "rabid Boston Celtics fan."

GEOFFREY BOISI
JAMES GORTER
Partners
Goldman, Sachs

At 40, Boisi (pronounced bwa-see), has brokered as many king-size deals as anyone—including Texaco's benighted match with Getty Oil. Elevated to co-head of investment banking at Goldman in 1985, he ascended to the management committee last year. He



Peter Buchanan of First Boston Corp

teams with Gorter, 58, his titular equal and Goldman's savvy Chicago-based Midwest mergers chief. The two helped engineer seven of last year's 20 biggest deals, including the $6.5 billion General Electric-RCA merger, USX's $3 billion merger with Texas Oil & Gas and R.H. Macy's $3.7 billion leveraged buyout. Their department also underwrote 83 domestic stock issues worth $8.7 billion, tops on the Street.

Last year Boisi's 2% to 3% of the partnership would have yielded him a $1.6 million to $2.4 million cash distribution along with his $100,000 to $200,000 salary. His stake's worth would have risen between $4.8 million and $7.1 million, putting his total compensation between $6.5 million and $9.7 million. The more senior Gorter collected slightly more.

PETER BUCHANAN

Chief Executive Officer

First Boston Corp.

Among Peter Buchanan's office knickknacks is a "PB" branding iron, a fit trophy for one who has forcefully beefed up First Boston's investment banking muscle. In 1986, First Boston's venturous bankrolling of Campeau Corp.'s takeover of Allied Stores gleaned $100 million in fees—the most ever on Wall Street for one deal. First Boston's net income last year hit a record $180 million, up from $130 million in 1985.

But success has come dear. Buchanan's drafting of costly talent has depressed First Boston's return on equity. Chief executive since 1983, Buchanan, 52, a blunt-spoken former equities trader who lives in Madison, N.J., and graduated from Princeton, earned $3.2 million in cash, dividends and stock last year. For escape from daily pressures, he likes to fish and golf.

B. GERALD CANTOR

President and Chairman

Cantor Fitzgerald

On Wall Street they know "Bernie" Cantor as a specialist in government securities and money market instruments. Uptown, he is better known as the world's greatest private collector of Rodin. Over the years he has owned 700 pieces by the French sculptor, donating more than 400 to museums and universities. That still leaves plenty to grace his Park Avenue apartment and Beverly Hills house, along with paintings by Sisley and Utrillo.

Even if 1986 wasn't Cantor's most profitable year ever, it was lucrative. Cantor, 70, the largest stockholder in his firm, made about $11.3 million, compared with $12.6 million in 1985. Lower commissions, more employees and new offices in London and Tokyo crimped profits. The firm's capital: $62 million.

DONALD CARTER

President

The Carter Organization

One of the kings of proxy solicitation, the raspy-voiced Carter, 39, earned $16 million in 1986 as business boomed on several fronts. Measured in revenues, his 15-year-old Carter Organization enjoyed a 20% rise in takeover consulting, a 15% gain in proxy solicitations and, most significantly, a 35% jump in corporate governance consulting.

Last year, the firm's consulting activities included representing Campeau Corp. in its $3.5 billion takeover of Allied Stores, and Goodyear as it fought off a raid by Sir James Goldsmith. In its fast-growing corporate governance area, Carter's firm provides clients with analyses on such hot issues as operating in South Africa, adopting antitakeover measures and even simply helping companies identify their shareholders.

PETER COHEN

CEO and Chairman

Shearson Lehman Brothers

These are hectic times for Peter Cohen, who was 36 when, in 1983, he became the youngest chief executive of any major securities firm. He recently sold a 13% stake in Shearson to Nippon Life Insurance Co., and took the firm public on behalf of parent American Express. As part of that deal, for 1986 Cohen earned nearly $1 million from stock options in addition to his $3 million compensation.

Coniston Partners: Augustus Oliver, Keith Gollust, Paul Tierney

Soon after he joined Shearson ($4.6 billion in revenues), Cohen guided its expansion into investment banking and real estate. Smart in the ways of the Street—after stints at Reynolds Securities and Republic National Bank—Cohen initiated the acquisition of Geneva-based Trade Development Bank and was a major force behind Shearson's successful public offering.

CONISTON PARTNERS

Keith Gollust
Paul Tierney
Augustus Oliver
General Partners

Find undervalued companies and put them into play, and hope to cash out when a higher bid comes along. That's the Coniston approach, and it works brilliantly. Its latest target is Allegis: It recently increased its stake in the airline to 13% and plans to unseat the company's board. This follows the four killings they made in 1986. They bought Cyclops at around $40 and sold it for between $60 and $73. They bought 8.5% of NL Industries at an average price of $13.80 and sold it at $14.90. They made a 33% profit on a 12% stake in Viacom and enjoyed a 45% return on two-thirds of their investment in Gelco. They subsequently bought more Gelco shares, which they still own. For their efforts, Gollust, 41, and Tierney, 43, former investment bankers at White, Weld & Co. who initially linked up in 1978 and formed Coniston in 1982, made $11 million apiece. Oliver, 36, a former M&A attorney for Skadden, Arps, Slate, Meagher & Flom, who joined Coniston in 1984, got $7 million.

MICHEL DAVID-WEILL

Senior Partner
Lazard Freres & Co.

Sorry, arbs. Now that the Feds have busted Ivan Boesky, who topped last year's list with $100 million, 1986 honors go to investment banker David-Weill, with an estimated $125 million from his stakes in Lazard Freres New York, Paris and London. The New York operation is said to have reaped record profits. Highlights include serving as an advisor to Burroughs Corp in its $4.8 billion merger with Sperry; representing RCA in its $6.5 billion merger with General Electric; and advising ITT on a $1.25 billion divestiture. Lazard also handled four IPOs totaling $1.369 billion.

Unfortunately, David-Weill got caught up in an allegedly fraudulent tax shelter in which authorities say he erroneously reported $4.4 million in tax deductions. The matter has since been settled.

Homes include his principal residence in Paris, a Manhattan apartment and grandiose estates in Locust Valley, N.Y. and Cap d'Antibes.

J. MORTON DAVIS

Chairman and President
D.H. Blair & Co.

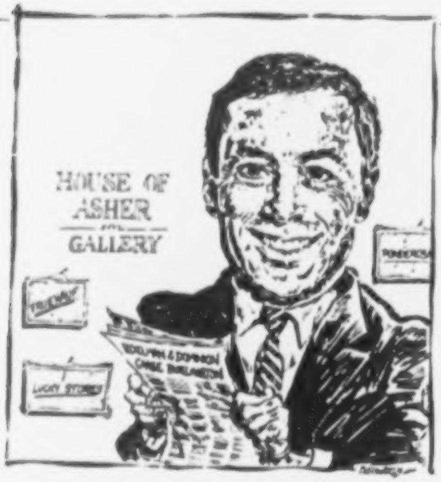
On a crisp November morning at the corner of Broad and Wall, a costumed Cleopatra sat in a sedan chair, artfully publicizing yet another initial public offering by Davis—this time, Cleopatra Kohlique. With $180 million in underwritings last year, Davis boasts he is No. 1 in IPOs. Among his recent winners: Cytrx, issued at 6 and now at 41, and Organogenesis, issued at 16 and now at 65. He also had some dogs, notably Mikron Instrument, which went from 5 to a current 1¼, and Vista Films, issued at 6 but down more than 50%.

Now 58, he allows that he earned between $60 million and $65 million in 1986, and his net worth is around $225 million ("but I haven't counted it lately"). He is considering an IPO for Blair ($100 million net capital), where he started in 1961 as a nominal 1% partner and is now sole owner, "provided the price is right. We are not looking to bail out."

RICHARD DENNIS

Partner
C&D Commodities

The ranking titan of futures traders, Dennis, 38, parlayed short positions in energy futures and long stakes in bond and currency futures into about $80 million of personal profit in 1986. This thoughtful, soft-spoken wizard of contrarian bent began dabbling in fu-



Asher Edelman of Plaza Securities

tures as a Chicago teenager with $400 saved from a pizza-delivery job.

Now he places trades by day from a computer-dominated Chicago office, and by night from his Lake Shore Drive apartment, which he shares with his father. He runs about $100 million of his own money and another $100 million for private clients. Liberal politics is Dennis' other reigning passion. He helps bankroll The Roosevelt Center for American Policy Studies, a Washington, D.C. Democratic think tank, and plans to launch a new political journal.

THOMAS DITTMER
Chairman
Refco Group

Legendary in Chicago for his scrapes with regulators and his lavish parties, Dittmer, 45, heads Refco Group, the umbrella for, among other things, the firm that now bills itself as the world's biggest registered futures brokerage, with assets exceeding $1.5 billion. The hard-charging, controversial Dittmer built Refco from a Midwest cattle-trading outfit in the early 1970s and remains one of the nation's biggest cattle and hog barons, with feeding operations in Texas and Iowa. He forsook trading—a onetime obsession that brought him and Refco lawsuits and at least one huge fine—two years ago. His firm turned a profit of more than $15 million in 1986 from its brokering and clearing operations. Dittmer earned at least $10 million from his more than 80% stake in Refco.

DAVID DREMAN
Managing Director
Dreman Value Management

The man whose 1980 book, *Contrarian Investment Strategy*, made *contrarian* a buzzword—he credits his Random House editor, Jason Epstein, with the coinage—Dreman shepherded his managed accounts to a meager 13.3% gain in 1986. Nevertheless, he pocketed more than $7 million. But Dreman, whose big holdings of Textron, Lockheed and Federated Department Stores got maimed in the Boesky backlash, earns his lordly wage. A scholarly, 51-year-old champion of low-p/e, high-yield stocks who launched his New York firm in 1977, Dreman boasts he has eclipsed 98% of his profession over the past five years and was up 21.6% in 1987's first quarter. Little wonder that Dreman's managed assets have swelled to $3.1 billion from $955 million at 1986's start.

ASHER EDELMAN
Managing General Partner
Plaza Securities
Arbitrage Securities

Can an arb run a business? Media-conscious Edelman, 47, has tried with scant success, failing to produce many breakthroughs in computer products and services at Datapoint, Intelogic Trace and Mohawk Data Sciences. He's had more success using pension funds and loose cash from firms he acquires to finance his trades. Altogether, Edelman may have made between $25 million and $30 million last year. Much of that came from the $51 million in profits and reimbursed expenses he received when Fruehauf sold out to a group headed by Merrill Lynch. Edelman claims he often buys less than 5% of a company's shares to avoid filing documents with the SEC. "Most of the deals I'm involved in never get publicized," says Edelman, who is now trying to manage the Ponderosa restaurant chain.

MAURITS EDERSHEIM
Deputy Chairman of the Board
Drexel Burnham Lambert

Now 69, and a 37-year veteran with Drexel Burnham, Edersheim signed on in 1950 from Stern & Co. to head what was then Burnham's foreign operations. Edersheim is now deputy chairman. As such, he oversees three international equity funds, including the two offshore funds, the Worldwide Special Fund NV and the Worldwide Securities Fund. The third fund, Fenimore International, which was started in March 1986, is registered in the U.S. and posted a 25.7% gain last year. Not surprisingly, after so many years on the Street, Edersheim manages some sizable private accounts and

Nicholas Forstmann of Forstmann Little

also ranks among Drexel's largest shareholders. For 1986 his compensation is believed to have been in the $5 million range. Dutch-born and Columbia-educated, Edersheim, who came to the U.S. at age 21 and served with the Office of Strategic Services during World War II, and travels the world in search of exotic railroad trips.

RICHARD FABIAN
Editor
Telephone Switch Newsletter

Says Fabian, "I [might be] the dumbest newsletter writer in the world, but I'm the richest." Last year, Fabian, 68, sold 34,000 subscriptions at $117 a pop and managed some $115 million. Earnings? At least $3 million to $4 million.

Fabian's investment philosophy is to switch from money market funds to no-load mutual funds whenever a fund's price is higher than its 39-week average at the same time that the Dow Industrials or Transportations exceed their respective 39-week moving averages. If those prices slip below that 39-week level, he believes one should switch back to cash. Follow that advice, he pledges, and your money will grow 20%, compounded annually. In fact, his equity/cash portfolio only rose by 10.7% last year, slightly better than 1985's 8.5% rise but much better than 1984's 12.1% decline, says newsletter maven Mark Hulbert.

FORSTMANN LITTLE & CO.
Theodore Forstmann
Nicholas Forstmann
Brian Little
Principals

Known as the Rolls-Royce of LBO specialists, Forstmann (Ted, 47, and brother Nick, 40) and Little (Brian, 45) amply proved their worth with last year's resale of Dr Pepper. Only two years earlier, that deal was derided as the LBO most likely to fail. Instead, equity investors got an 8½-fold return on their money. As a rule, the company deals only in friendly acquisitions, installs its own management expertise and eschews junk bonds, relying instead on pension funds. Another wrinkle: Their 1.5% management fee on clients' funds drops to 0.5% when the money is invested.

With their record of 35% compound annual returns on borrowings, such pension funds as AT&T, General Electric, Honeywell, Boeing and American Express rushed to join their $1.5 billion buyout fund. Other backers include Forstmann sibling Anthony, co-founder of Forstmann-Leff, recent Morgan Stanley hire Lewis Lehrman and auto racer Roger Penske. An early tie to Ivan Boesky was severed.

Recent acquisitions included Midland-Ross, Sybron Corp. and Lear Siegler. The firm's take: 20% of all profits. With the largest stake, Ted, an all-American hockey goalie at Yale, made at least $20 million in 1986, Nick and Brian about $15 million apiece.

STEPHEN FRIEDMAN
ROBERT RUBIN
Partners
Goldman, Sachs

In May 1986, colossal blunders in Treasury-bond trading cost Goldman as much as $100 million. The onus for the loss presumably fell on Friedman and Rubin, the joint chiefs of fixed-income trading. But the duo recruited new trading talent from archrival Salomon and managed to deliver a profit for the year. Friedman, 49, a fidgety ex-lawyer with a quick tongue, started at Goldman in 1966 and, as head of M&A and later as co-head of investment banking, cut a path for his astute protege, Geoffrey Boisi, now the banking co-head.

The 48-year-old Rubin, an even-tempered Yale Law School alumnus and former New York State finance chairman for Walter Mondale's 1984 presidential campaign, wears three hats at the firm: overseeing equity trading and arbitrage (with Robert Mnuchin), Goldman's J. Aron commodity-trading arm, as well as fixed income. He and Friedman are each said to own 2% to 3% of the firm, stakes that would have brought them $1.7 million to $2.6 million apiece in cash distributions and salary.

Meantime, their respective pieces of the firm grew between $4.8 million and $7.1 million, putting their total compensations between $6.5 million and $9.7 million.

Alan Greenberg of Bear, Stearns

ERIC GLEACHER
Managing Director
Morgan Stanley

Much of Morgan Stanley's reemergence as a power in merger deals can be traced to Eric Gleacher, 47. All told, his M&A group handled deals worth $75 billion, including Kohlberg Kravis Roberts' leveraged buyout of Safeway Stores; Gleacher personally arranged the costly greenmail defense Gillette staged against Ronald Perelman, who retreated with $34 million in profit. Ironically, he had earlier assisted Perelman in his takeover of Revlon. Prior to that his most celebrated feat was to engineer Union Carbide's outflanking of GAF's tender offer. He made $3 million to $5 million.

DANIEL GOOD
Managing Director
Shearson Lehman Brothers

Although Dan Good joined Shearson as head of leveraged buyouts in mid-1986, by year-end he completed 10 deals that together fetched fees approaching $100 million. Among these was Shearson's share of the $58 million that raider Paul Bilzerian ahd his two pals pocketed when Hammermill linked up with International Paper. The 47-year-old Good also prospered even though client Edward DeBartolo Sr. lost his bid for Allied Stores to Campeau.

Altogether, Good walked away with roughly $5 million for himself last year, much more than he received the two preceding years at E.F. Hutton or during any of the 20 preceding years at A.G. Becker.

DAVID SANFORD GOTTESMAN
Managing Partner
First Manhattan

David "Sandy" Gottesman's First Manhattan managed over $3 billion in assets last year, for a 1% fee. The firm's basic investment philosophy is pure Graham and Dodd, an increasingly difficult game these days.

Nevertheless, sources estimate that the 23-year-old firm earned $25 million in 1986, making Gottesman's 40% stake worth about $10 million in pay. And that doesn't include income from other investments such as Central National–Gottesman Inc., a pulp and paper trading company that holds much of the Gottesman family fortune. Gottesman, 61, a graduate of Trinity College and Harvard, is also a director of Sun Chemical.

ALAN GREENBERG
Chairman
Bear, Stearns

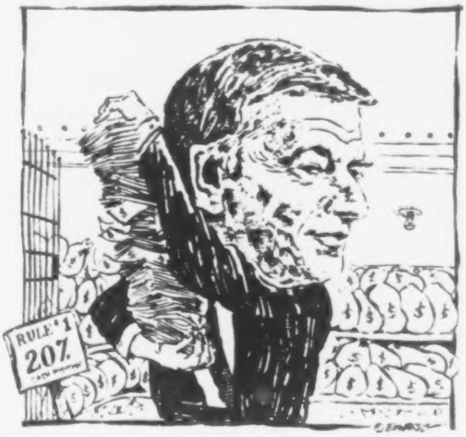
For a boy who started out in Wichita, Kan., Alan Courtney "Ace" Greenberg, 59, has come a lot farther than Dorothy ever dreamed possible. Bear, Stearns has been Greenberg's home since he finished college in 1949 and landed a $135-a-month job at the firm. He's been lord of the Bear, Stearns castle since 1978. Since that time, he has moved the company from marginal status to ninth among Wall Street's top firms.

A celebrated champion bridge player as well as a gifted amateur magician, last year his total of salary, bonus and dividends from the company earned him more than $6 million. His stock in the company is worth $8.5 million more. Greenberg, though, gives whopping sums to charity each year, and requires that his top managers and officers do the same with at least 4% of their total pay.

JOHN GUTFREUND
Chairman and CEO
Salomon

Gutfreund, who collected $3.1 million last year, is the first to admit that Wall Street is overpaid. But then he has more than most to show for his income. Building on Salomon's historic trading prowess to snare institutional clients, the ex-bond trader has increased the company's financial muscle impressively since taking over as sole CEO in 1984, when he ousted co-CEO David Tendler.

In 1986, Salomon, with $3.2 billion



Leonard Heine Jr of Management Asset

of total capital, edged out Shearson Lehman Brothers as the best-capitalized firm on the Street. But there were snags. Salomon's net profit tumbled to $516 million last year from $557 million in 1985, owing to its costly expansion overseas and hefty trading losses. Like Billy Salomon in days past, Gutfreund still prefers the din of the Salomon trading floor, where he often works, to the executive suite.

LEONARD HEINE, JR.
President
Management Asset

"The two critical aspects basic for any investment program," says the 62-year-old Leonard Heine, "are discipline and consistency." His Management Asset Corp. has had a 23% average annual rate of return over the past nine years. Heine earned about $6 million last year. "Consistency pays off," says he.

Heine, who graduated from Wharton in 1948 and then worked for Lehman Brothers and L. F. Rothschild, founded Management Asset in New York in 1970, but moved to Westport, Conn., in 1973, "for a better way of life." Assets under management have climbed from $10 million in 1977 to $1 billion today, 50% of which is in cash. Revenues amount to $8 million for the Graham and Dodd investor.

MAX HEINE
President
Heine Securities

A 76-year-old who fled Nazi Germany in 1934, Heine these days entrusts most of the brainwork of guiding Heine Securities, a cluster of three mutual funds, to his 35-year-old partner and protege of a dozen years, Michael Price. Price may reap the acclaim, but Heine, a 99% owner of the outfit he built, reaps the money: probably more than $5 million in 1986 on some $2 billion of managed assets. Crafty connoisseurs of distress cases, the pair scored big last year with their $200-million-plus of bankrupt Storage Technology's notes, with Interlake's and Viacom's common (Viacom was taken over), and with shares of thrifts going public—to deliver an overall 16.5% gain to the $1.7 billion Mutual Shares fund, their biggest. Come 1990, Price will buy out Heine's stake and draw commensurate pay.

J. TOMILSON HILL
STEPHEN WATERS
Managing Directors
Shearson Lehman Brothers

These Harvard-schooled virtuosos are on a tear. The co-heads, since 1985, of Shearson's mergers unit, they collected $3 million to $4 million apiece last year mediating some 200 deals worth $30 billion—a Shearson record. Among the biggest of these: Unilever's $3.1 billion takeover of Chesebrough-Pond's and Allied-Lyons' $1.2 billion purchase of a controlling stake in Hiram Walker's liquor unit. Lately they've helped broker Chrysler's proposed takeover of American Motors. Waters, 40, forged the old Lehman Brothers mergers unit in 1974 with Eric Gleacher (now Morgan Stanley's ace). In 1982 he was joined by Hill, now 39, who learned his craft in the mid-1970s at First Boston.

RICHARD ISAACS
Senior Vice President
Donaldson, Lufkin & Jenrette

Let's hope Isaacs is satisfied with his 1986 take: between $5 million and $8 million. Four years ago, he walked out of Lehman Brothers when it wouldn't double his $2.5 million compensation, even though he claimed he accounted for nearly one-third of the firm's earnings the year before. The flamboyant Isaacs, 37, arbitraged government and mortgage-backed securities and soon showed up at DLJ to launch its MBS department, for a somewhat larger sum. Any satisfaction was short-lived. Within two years, Isaacs moved his three-person operation to Beverly Hills. Now he drives to work in a Ferrari and calls it a day by 1 p.m.

Edward Johnson of FMR Corp.

EDWARD JOHNSON III
Chairman and CEO
FMR

The shy 56-year-old Johnson has turned the company his father founded 40 years ago, better known as Fidelity Investments, into a ubiquitous mutual fund marketer. Today, it has over 125 funds, including the legendary Magellan Fund—the decade's best performer—and over $79 billion in assets under management, up from 13 funds and $3 billion worth in assets in 1974. Operating income from financial services, the bulk of the private firm's business, was $87.2 million last year. Johnson owns 40%, so figure his share at $35 million pretax and before any distribution.

ROBERT JOHNSTON
President
Beacon Hill Financial

A natural money matchmaker who finds alternative investments for very large institutional managers, Johnston can take credit for being among the first to introduce pension funds to LBOs in 1982. Last year, he helped longtime client Forstmann Little raise $1 billion in a private placement—the third deal they have done together—and found $157 million for Nightingale Atlantic Partners, a British-based LBO firm. He helped Savage Industries, a troubled firearms company, recapitalize its debt. For these and other services, Johnston charges the borrowers between five-eighths of 1% and as much as 4% of the total sum. Johnston, 38, is sole owner, and made about $5 million in 1986. This year should be better. Published reports say Johnston is currently raising nearly $1.5 billion.

PAUL TUDOR JONES II
President
Tudor Investment

Sensational gains are becoming old hat for this energetic futures account manager. A deft timer of markets, Jones, 32, rallied from a summer debacle to deliver a 98.4% return to his clients in 1986—after exacting $11 million in fees for himself. He had performed even better in 1984 and 1985, conjuring returns of 529.8% and 136.4%.

A former cotton exchange floor trader who plies his craft from New York, Jones claims to trade "from the hip." But he looks before he draws: His biggest 1986 scores—in long S&P 500 futures positions—stemmed from painstaking probing of recent and historic market behavior. His results have helped catapult the total assets under his firm's management from a mere $850,000 to $120 million in only three years.

FREDERICK JOSEPH
Chief Executive Officer
Drexel Burnham Lambert

There's more to Wall Street's second-largest (in capital) private house than junk bonds and insider trading allegations: for example, record earnings ($545.5 million on $4 billion in revenues), a 130% increase in lead-managed underwritings and the hiring of its 10,000th employee. But, as Joseph says, "1986 was a sobering year for Drexel Burnham." Talk of abusive business practices, as well as M&A specialist Dennis Levine's criminal activities, stained Drexel's reputation and put the inventive Joseph, 50, on the defensive. Joseph has more at stake than just his $5 million salary. Arriving at Drexel in 1974, he helped mastermind the corporate finance unit, and his appreciation of junk bonds ultimately spawned a Wall Street revolution.

STEPHEN JOSEPH
Senior Vice President
Drexel Burnham Lambert

Plucked from Salomon Brothers' mortgage-backed securities department three years ago, Joseph, 44, was asked to build a new MBS unit for Drexel in an attempt to catch up with Salomon and First Boston without stumbling in the process like Merrill Lynch. Starting virtually from scratch, the personable Joseph—who is the

please turn to p. 105

continued from p. 44

George Kellner of Kellner, DiLeo

brother of Drexel's CEO Fred Joseph—created a unit that now numbers 350 employees. Trading volume swelled from $3 billion in December 1984 to $31.2 billion last December.

An avid deep-sea fisherman, Joseph says he spends a lot of his time during the summer looking for shark and tuna. These days, Joseph also oversees Drexel's taxable fixed-income sales force of about 300. Sources believe he earned approximately $3 million in 1986.

KELLNER, DILEO

George Kellner
Philip DiLeo
Managing Partners

George Kellner, 44, and Phil DiLeo, 39, have created a formidable presence in the arbitrage community. In recent years, their six- year-old New York firm has rung up average annual gains of about 60% before payouts to partners. Although in the past they were proud to have been Boesky disciples, they now stress that they "concentrate on announced deals and put much less emphasis on anticipatory" takeover transactions. Sources say the firm earned some $40 million last year, from which Kellner, a champion squash player, claimed at least $7 million to $8 million. DiLeo, who breeds and races horses got a minimum of $3 million to $4 million. But arbitrage isn't their only endeavor. Three years ago, the firm established KD Associates, a private equity fund that has thus far invested $25 million in LBOs. In one of its recent coups, the fund made a $97.5 million profit when it sold its 82% equity stake in Allsteel Inc., which it acquired for $60 million.

H. FREDERICK KRIMENDAHL II

Partner
Goldman, Sachs

As chief of operations and administration, Krimendahl, 58, a Goldman partner since 1963, oversees global growth. Goldman launched on-site trading in Tokyo and London last year, and Krimendahl's turf now stretches to 19 offices harboring 6,000 employees (up from 4,500 in 1985). Krimendahl sits on the boards of five companies and is a member of the Philharmonic Symphony Society of New York and an avid New York Giants supporter. He probably earned $1.7 million to $2.6 million in cash distributions and salary from his reported 2% to 3% Goldman share, which grew in worth by between $4.8 million and $7.1 million in 1986. Total compensation came to between $6.5 million and $9.7 million.

JOHN KISSICK

Executive Vice President
Drexel Burnham Lambert

This 45-year-old runs Drexel's mammoth corporate finance office in Los Angeles—a unit he helped build from scratch. Today, he supervises the investment banking activities of over 100 Drexel employees. But one of his own claims to fame, sources say, was establishing Drexel's long and fruitful investment banking tie with Armand Hammer, chairman of Occidental Petroleum. Kissick, who holds a B.A. from Yale and an MBA from Stanford, began his career in 1970 as an associate in Blythe & Co.'s corporate finance unit and arrived at Drexel in 1975. Last year, he made at least $5 million.

KOHLBERG KRAVIS ROBERTS

Jerome Kohlberg
Henry Kravis
George Roberts
Robert MacDonnell
General Partners

Established in 1976, KKR, the premier leveraged buyout firm, has a $2 billion buyout fund. Minimum deal: about $500 million. The firm is credited with institutionalizing LBOs. KKR charges a 1.5% annual management fee on each of its buyout funds, and a 1% investment adviser fee. In addition, it gets 20% of profits. The firm is now more active in selling and reorganizing than in buying, although it acquired Beatrice, Owens-Illinois and Safeway Stores last year, receiving $165 million in fees. KKR spun off Beatrice's bottling and personal products divisions for $2.25 billion and Avis for $1.6 billion. It sold PT Components, Wometco Cable TV and Lily-Tulip in deals val-

Donald Marron of PaineWebber Group

ued at $800-million-plus. Kohlberg, 61, attended Columbia Law School and is known as the engineer behind KKR's buyouts. Kravis, 43, the son of a Tulsa oil geologist, collects 19th-century British paintings and is a New York City Ballet board member. Roberts, 43, Kravis' cousin, runs the San Francisco office. Each is estimated to have made $50 million last year. Robert MacDonnell, 48, with a smaller stake, made about $15 million.

BRUCE KOVNER
President
Union Financial
Caxton

In January and February of 1986 alone, a prospectus reveals, Bruce Kovner turned $43.9 million into $76.9 million in the futures accounts he manages, netting himself $4.9 million in fees. That kind of trading success has often escaped this secretive 41-year-old, a former Harvard teaching fellow and public policy consultant. But by year's end, says a source who knows him, Kovner "conservatively" had made $15 million—excluding any gains or losses from his private trades—as his companies' managed assets grew to over $200 million. Kovner trades currency and financial futures from his amply wired Manhattan home and from outposts in Princeton, N.J., and on Long Island, using computer trading programs he devised himself.

DEAN LEBARON
President
Batterymarch Financial Services

Slews of institutional clients fled LeBaron's fold last year—the fallout from his two-year run of mediocrity. As solace, the flamboyant money manager, acclaimed as a contrarian genius in the mid-1970s for his prescient buys of underrated stocks, can look to 1986's second half: It was then that LeBaron's computer-picked plays in energy and cyclical stocks at last shot up, salvaging for Batterymarch's portfolio a humdrum 16.3% annual gain.

That, of course, didn't halt the erosion in 1986 of LeBaron's Boston-based empire—from $11.9 billion to $9.2 billion of assets managed—or of his take. But Batterymarch's sole owner is no pauper. Sources say the 54-year-old bachelor, who has a taste for sports cars and sailing, gleaned about $10 million for himself.

DONALD MARRON
Chairman
PaineWebber Group

Thanks to the major improvements he put in place in PaineWebber's retail brokerage and fixed-income trading operations, 52-year-old chairman Don Marron has managed to raise the firm's net income more than sixfold and has more than doubled the company's return on capital in the past two years. Specifically, he rooted out unproductive brokers and recruited Rafe de la Guerroniere from Morgan Guaranty to head up fixed-income trading. So it's not surprising that the 10-year PaineWebber veteran was handsomely compensated in 1986. According to the company's proxy, Marron, a former head of major research boutique Mitchell Hutchins who was named chief executive in 1980 and chairman in 1981, earned a total of $3.8 million last year from three sources: cash compensation of $2,725,000, about $453,000 in various options plans and 18,750 shares of restricted stock that is valued at around $590,000.

LEO MELAMED
Special Counsel
Chicago Mercantile Exchange
President
Dellsher Investment

Though no longer chairman of the Merc, whose leadership he seized in a 1969 coup prior to launching—with Nobel economist Milton Friedman—the financial futures revolution of the early 1970s, Leo Melamed is still a crusading, voluble power broker at the exchange. Now in his 50s, he pushed hard for the Merc's trading link to the Singapore International Monetary Exchange and is brainstorming cures for the notorious "triple witching hour" market havoc. But those issues fill only his afternoons. Weekday mornings he trades—what else?—financial futures.

Michael Milken of Drexel Burnham Lambert

Associates say he tallied $3 million to $4 million in 1986 gains from long currency and Treasury bond positions. At night and on weekends last year, this Life Master bridge champion penned a science-fiction novel, *The Tenth Planet*, to be published this September.

RICHARD MENSCHEL

Partner
Goldman, Sachs

In charge of securities sales, a job he has held since 1969, Menschel oversaw the marketing of $70 million worth of securities that Goldman had a hand in underwriting last year. When not pitching Goldman's wares, he indulges in literary classics and fine arts. He serves as a director of New York City's Municipal Art Society and trustee of the International Museum of Photography in Rochester, N.Y., and formerly was president and director of the foundation for the Joffrey Ballet. Menschel, 53, owns 2% to 3% of Goldman, from which he likely took home at least $1.7 million in salary and cash distributions. The worth of his partnership holding rose $4.8 million or more. Total compensation: $6.5 million to $9.7 million.

DAMON MEZZACAPPA

Partner
Lazard Freres

In 1981, the emotional, hard-charging 51-year-old Mezzacappa left Morgan Stanley to join Lazard Freres with the mission of starting up equity and fixed-income trading operations for the investment banking house. A pioneer in stripped securities, and an aggressive trader by nature, Harvard alum Mezzacappa very soon had his units contributing nearly half of Lazard's earnings.

Today, he says he gets "involved in almost all aspects of the firm," not just the securities trading and underwriting he heads at Lazard.

Last year, under his direction, Lazard Freres more than doubled its IPO underwriting activity, which included handling the $1.2-billion initial public offering of The Henley Group, the year's largest new issue: an eclectic mixture of nondescript companies that was spun off by Allied-Signal. Sources say Mezzacappa earned a minimum of $3 million to $4 million last year, although it may well have been a lot more than that.

MICHAEL MILKEN

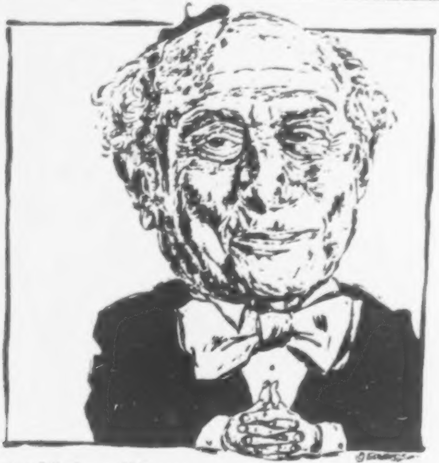
Senior Executive Vice President
High Yield &
Convertible Bond Dept.
Drexel Burnham Lambert

Drexel's grip on the junk bond market fell to 45% of all underwritings from 54% in 1985. But volume jumped 76%, and sources believe that Milken, 41, the *sine qua non* of junk bond financing and sales, earned somewhere between $27 million and $50 million from his unit's profits. On top of that, observers believe he made upwards of $30 million from other investments, including equity stakes in Drexel deals. Altogether, he made as much as $80 million, excluding $21.8 million from the rise in the worth of his reputed 4% stake in Drexel. The elusive Californian doesn't comment on these matters. In fact, as part of a sworn deposition taken from him last September, which found its way into the *Los Angeles Times*, Milken claimed to be "not familiar exactly with my current ownership in almost any investment."

ROBERT MNUCHIN

Partner
Goldman, Sachs

Along with Robert Rubin, this bearded 53-year-old presides over an equity trading and arbitrage operation that executed no less than 16% of all block trades on the Big Board last year. Goldman also wagered heavily for its own account last year, raking in perhaps $200 million in arbitrage profits. Mnuchin played a leading part in reorganizing three of the city's municipal pension funds in the late 1970s. This block-trading ace likely took in $1.7 million to $2.6 million in salary and cash distributions from a 2% to 3% share in the firm. The value of his share rose between $4.8 million and $7.1 million last year. Total compensation: $6.5 million to $9.7 million.



Roy Neuberger of Neuberger & Berman

A. BREAN MURRAY
Chairman and CEO
Brean Murray, Foster Securities

With close to $400 million now under management, Brean Murray himself earned around $5 million in 1986. The 50-year-old Irish-born executive and graduate of Villanova University founded this Wall Street money management and institutional brokerage firm nearly 14 years ago with only $100,000 in capitals. Murray now owns a quarter of the business, which has never suffered a losing year. Sources say 1986's profits reached $20 million.

Although the firm is known for its research capabilities, its best-performing units last year reportedly were its institutional sales and money management divisions. Late last year, the firm launched an expansion program aimed at money management, mergers and acquisitions and development of new financial products.

Brean Murray also has one of the fastest-growing staffs on Wall Street. Its latest coup: hiring Alan Landis, last year's top equities salesman at Nomura International Securities.

NEUBERGER & BERMAN
Roy Neuberger, Senior Partner
Lawrence Zicklin, Mg. Partner
Albert Cohen, Partner
Marvin Schwartz, Partner
Philip Straus, Partner

To Roy Neuberger, 83, managing money is an art. He studied art in Paris and has managed money since the 1920s, applying to both the same strategy of looking for undervalued situations. Nowadays much of his art collection is housed at the State University of New York, and he handles only the $175 million Eastman Kodak account, although he trades daily on his own account. His 1986 take: $4.5 million.

Fifty-one partners and managers run N&B by serving on the firm's six-person rotating executive committee. Veterans of more than 25 years, Marvin Schwartz, 47, and Philip Straus, who admits to being in his 70s, aggressively trade for their own accounts. They earned a minimum of $6 million and just over $7 million, respectively. Straus has been at N&B since 1945 and Schwartz is said to have N&B's best long-term performance record. Albert Cohen, 64, the expert arbitrager, who joined N&B in 1972, is said to have earned about $5.5 million. Lawrence Zicklin, 50, the top administrator, reportedly made about $6 million.

ODYSSEY PARTNERS
Leon Levy
Jack Nash
General Partners

It's been a financial odyssey ever since they sold their controlling interests in Oppenheimer & Co. to London's Mercantile House Holdings in 1982. Last year their New York partnership (about $600 million of capital) appreciated by more than 30%. "Most of our gains were singles and doubles," says the baseball-minded Nash. This includes the $15 million or so Odyssey made selling New American Library to Penguin, and an undisclosed amount on shares of Plitt Theatres that went to Cineplex Odeon. Odyssey also made out well in its 7% investment in ADT, buying the stock in the low 20s and selling it at 32. It still owns 10% of Monarch Capital Corp., which has risen to the low 70s since Odyssey bought it in the low 40s. This enabled Levy, 61, and Nash, 58, to take home about $20 million apiece. Their investment performance also boosted the income of FW 100's Jeffrey Tarr and Fayez Sarofim, also Odyssey limited partners.

JOSEPH PERELLA
BRUCE WASSERSTEIN
Managing Directors
First Boston

This deal-making pair, aged 46 and 39, respectively, emerged as swashbuckling superstars in the early 1980s with their roles in mammoth oil mergers. The 240 or more M&A deals they clinched last year, with a market value of more than $75 billion, boosted First Boston's investment banking revenues to $670 million, from $383 million in 1985. Knowledgeable investment bankers

Bruce Wasserstein of First Boston

placed their take at $5 million to $6 million for Perella and close to $8 million for Wasserstein.

A brainy ex-attorney and onetime *Forbes* researcher, Wasserstein hammered out Burroughs' $4.8 billion takeover of Sperry with Lazard Freres' Felix Rohatyn and largely masterminded Campeau's $3.5 billion takeover of Allied Stores. In that precedent-setting deal, First Boston risked $865 million of its own to snare $100 million in fees.

Perella started First Boston's M&A unit in 1973 and hired Wasserstein in 1977. Known for his easy rapport with clients, Perella and his partner also helped negotiate First Boston's $800 million LBO of Union Carbide's consumer businesses.

LOUIS PERLMUTTER

General Partner

Lazard Freres

After earning a JD from the University of Michigan in 1959, Louis Perlmutter, 45, practiced law for five years. Later, he worked for White Weld and Merrill Lynch, where he ran the M&A group. At Lazard he helped shape Beatrice's purchase of Northwest Industries' beverage division in 1982 and last April's sale of Avis to Wesray Capital. He has written numerous articles on mergers and acquisitions. In a commentary that appeared last year in *Financier*, he stated that "the takeover market is undergoing another change, which will result in a slowdown in the frenzied pace of the past two years," adding he doesn't believe that the M&A industry is "in as bad shape as the doomsayers suggest." Perlmutter made about $3 million to $5 million last year.

PRINCETON/NEWPORT PARTNERS

James Regan

Edward Thorp

General Partners

Hedgers Edward Thorp, 54, and James Regan, 45, earned a hefty $8 million to $9 million apiece last year. Their secret weapon? A shrewdly programmed computer model which helps them zero in on juicy arbitrage and hedging opportunities based on an array of relationships between securities. The results have been impressive: Net profits approached 30% over the past two years. In fact, the 17-year-old firm has never had a losing quarter and can now boast approximately $200 million in capital. Last year saw two operational changes, says Thorp, a former math professor and an amateur astronomer. "We increased our leverage to raise our return on capital, which is currently averaging 30%, to a level where the partnership has a minimum of a one-to-one debt-to-equity ratio and sometimes as high as two to one. That means that the leverage occasionally might get as high as $400 million. We also made big profits by hedging interest-rate instruments." Thorp operates out of Newport Beach, Calif., while Regan is in Princeton, N.J.

JULIAN ROBERTSON

General Partner

Tiger Fund, Jaguar Fund, Puma Fund

Noted for his short temper, Robertson, 54, spent 22 years as chief investment officer at Kidder Peabody's Webster Management before starting Tiger in 1980. Robertson now runs four hedge funds—Tiger, Jaguar, Jaguar NV and Puma. Assets under management: $380 million. He requires a minimum $250,000 investment, with 20% of the market increase going to the general partners at year-end. After fees, Tiger's performance was 15.5% for 1986 compared to 63% in 1985. Companies shorted by Robertson include Mobil, Phillips Petroleum and Zenith Labs, the generic drug company on which Tiger lost money last summer. Robertson, who is sticking with his profitable long positions in S&Ls, probably made $3 million to $6 million last year.

FELIX ROHATYN

General Partner

Lazard Freres

As head of Lazard Freres' M&A department, Rohatyn, 59, was the matchmaker for the Sumitomo Bank-Goldman Sachs deal and helped negotiate GE's takeover of RCA. Valued at $6.5 billion, the RCA merger earned

Felix Rohatyn of Lazard Freres

his firm about $17 million. Vienna-born, Rohatyn started at Lazard as a summer clerk in 1949, making less than $38 a week. Figure his 1986 earnings came to $6 million. He is best known for solving New York City's fiscal crisis in 1975, but he has also written numerous articles on Third World debt. Last year, Rohatyn testified before the Senate Banking Committee against the "cancerous greed" of Wall Street and stated that we are in an "age of the financial samurai." Participating on a University of Michigan panel, he urged action to reform Wall Street's tarnished image.

CHARLES ROYCE

President
Quest Advisory

For Charles Royce, 47, last year's redeeming grace was his $3.5-million-plus in pay. His Royce Value and Pennsylvania Mutual Funds, having outraced the bull market in 1983 and 1984, gained merely 10.9% and 6.3% respectively in 1986. Meantime, the sartorially flashy money manager, who hails from the Graham and Dodd investing school and works in Manhattan, waits for the hex afflicting the undervalued, smallish but fast-growing companies he favors to lift. Among his picks this year: Frank Paxton Co., Showboat, Inc., and Kimball International. Whence his salary? Royce—a former research analyst who in 1973 took over the foundering Pennsylvania Mutual Fund and swiftly made it a winner—took in at least 75% of the fees from the $800 million of assets Quest managed.

HOWARD RUBIN

Former Vice President
Merrill Lynch

He once spent a year as a blackjack card counter in Las Vegas. Even so, friends were surprised when Rubin, 36, was fired this April in the wake of Merrill Lynch's $275 million loss from trading mortgage-backed securities. Rubin engaged in unauthorized trading in a relatively new, risky form of securities. "He didn't take any greater risks than his competitors," says a friend. Rather, Rubin, who joined Salomon Brothers in 1982 as a mortgage-backed securities trader after graduating from Harvard Business School, is credited with developing Salomon's profitable discount MBS business. Courted by several firms, he moved to Merrill in 1985. Now he has ample time to spend last year's $4 million income.

FAYEZ SAROFIM

Chairman and President
Fayez Sarofim & Co.

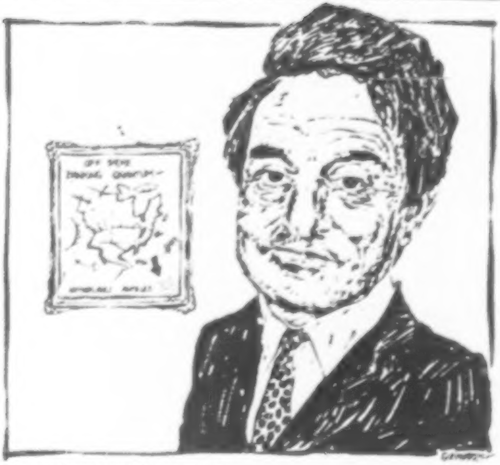
As the soft-spoken Sarofim, 58, says, "1986 was a good year." He long ago swapped his oil and gas holdings for such consumer goods firms as Coca-Cola, Anheuser-Busch and Procter & Gamble. Egyptian-born and Houston-based, he owns between 50% and 75% of the firm, which manages $12.3 billion in assets. He also owns half a million shares in Dreyfus Corp. stock, which went up 236% in two years, and his 9% holding in Teledyne has doubled in value in five years.

Sarofim, a limited partner of Odyssey, earned a minimum of $5 million in 1986 when dividends are included. While no longer such a large oil investor, Sarofim is still active in that industry: He is a director of PetroUnited Terminals Inc., a petroleum and chemical storage company.

DAVID SCHAFER

President
Schafer Capital Management

Although Schafer Capital managed nearly $1 billion in assets in 1986, it has only some 10 big pension funds as clients. Schafer himself started out after graduating from New York University as the pension fund manager for International Nickel, where his superior performance attracted attention from other pension fund managers. Striking out on his own in 1981, Schafer, 48, has a low overhead, with a staff of just five people, and charges a 1% fee for fund management. According to the *Money Market Directory of Pension Funds and Their Investment Managers*, Schafer's strategy is to be "fully invested at all times in large capitalization stocks of financially sound companies whose p/e's



George Soros of Soros Fund Management

are lower and earnings growth prospects higher than the S&P 500 over a five-year time horizon." The firm's revenues are estimated at $11 million. Schafer, as sole shareholder, earned close to $7 million, a hard-to-believe 64% profit margin.

RICHARD SCHMEELK
Executive Vice President
Salomon

Schmeelk, 62, led all of Salomon's ranking executives in 1986 pay, but not entirely for reasons of status. With his retirement pending, none of his $3.4 million salary was deferred. As head of corporate finance, he helped propel Salomon to No. 1 in U.S. corporate underwritings. But his clout in recent years has slackened, sources say, with the rise of executive vice president Thomas Strauss and other Young Turks.

Schmeelk did, however, make Wall Street's mightiest bond house a potent force in equities. Last year, Salomon topped Wall Street as the lead manager of 452 corporate issues worth $51.8 billion—ranking first in bonds and third in stocks. An ardent Republican, Schmeelk joined Salomon in 1946.

MARTIN SHAFIROFF
Managing Director
Shearson Lehman Brothers

"We want companies that people don't give a damn about," says Shafiroff, 48, who, in effect, is an extraordinarily prosperous old-fashioned broker with a large research staff of his own. With eight helpers, he pores through 10Ks and reports, searching, he says, "for overlooked companies with good fundamentals that have stubbed their toes." He more than doubled his customers' money in Supermarkets General and Anchor Glass Container, and nearly doubled it in 11 months in Chesebrough-Pond's before its takeover by Unilever. Early into Florida banks, Shafiroff is a sevenfold gainer there. He made $4 million in 1986.

ALVIN SHOEMAKER
Chairman
First Boston

The successor as chairman to First Boston's great strategic thinker, George Shinn, Shoemaker counsels and coaxes First Boston's well-heeled clients for chief executive Buchanan, who prefers to keep tight operational control of the 53-year-old firm. Although he is still comparatively young for the elder statesman role, his ambassadorial duties befit the affable Shoemaker, 48, who returned to First Boston in 1981 after PaineWebber took over Blyth, Eastman, Dillon, the investment banking house he ran for three years. One of the key accomplishments of this Wharton School alumnus occurred in the 1970s, when he hatched First Boston's underwriting business in municipal and U.S. government issues almost single-handedly. His 1986 reward: $3.1 million in cash, dividends and stock.

ALAN SLIFKA
General Partner
Halcyon Investments

Slifka (Yale '51) ran the arbitrage unit of L.F. Rothschild, Unterberg, Towbin until 1981 and then established Halcyon Investments. By last October, Halcyon's capital exceeded $220 million. For a while, Slifka had an even larger pile of assets to manage until Wesleyan University, one of five limited partners, pulled out. As one of the seven general partners at Halcyon, Slifka owns at least 10% of the firm. His cut came to about $3 million to $5 million, a figure that Slifka says "is not outrageously incorrect." Slifka, 57, is also the chairman and a big supporter of the one-ring Big Apple Circus. For reporters, he has a favorite saying, a quote from Winston Churchill: "Fate holds terrible forfeits for those who gamble on certainties."

GEORGE SOROS
President
Soros Fund Management

About the only disappointment Wall Street's Renaissance man has encoun-

Michael Steinhardt of Steinhardt Partners

tered of late is the withdrawal of Gary Hart, whom Soros supported. Otherwise George Soros, who ranks as Wall Street's second-richest man for the second year in a row, has a lot to be pleased about: a newly published book on finance, heavy endowments for education and the arts in his native Hungary, and an astounding winning streak in recent years for his renowned Quantum Fund. After a 122% appreciation in 1985, Soros' now $1.57 billion Quantum hedge fund, registered in the Netherlands Antilles, advanced about 45% last year. From that, Soros, 56, is said to have earned about $90 to $100 million from appreciation on his personal stake and his 2% management fee.

MICHAEL STEINHARDT
Managing Partner
Steinhardt Partners

Famous for its heavy trading, Steinhardt's shop fared well with the holdings it selected last year. His three hedge funds—Steinhardt Partners, Institutional Partners, Ltd. and SP Investors NV—rang up an impressive 40% average appreciation from which Steinhardt claimed roughly $40 million in earnings, "give or take $10 million," he says. Money under management ballooned by one-third during 1986 to about $900 million at year-end. It currently stands at about $1 billion. A renowned short-seller, Steinhardt, 46, daringly kept "over one-third of the portfolio in short positions for much of the time last year," he recalls. The result? "We made a modest amount on our shorts," he says, which, considering the market's overall direction, "was terrific." That he could have made quite a bit more if he had been 100% long doesn't even seem to occur to one who walks the path of legendary short artist Jesse Livermore.

JEFFREY TARR
General Partner
Junction Partners

Count Tarr's trading losses among the upshots of the Ivan Boesky affair. "We had a horrible period," says Tarr, 45. Even so, a record first half enabled Junction's sole general partner to make about $30 million for the year. This includes profits made on his own capital as well as his 20% take from his other 90 capital partners' profits in the $400 million to $500 million arb partnership. It also includes gains from other investments, among them his share of Odyssey Partners (See Leon Levy and Jack Nash p. 108.) While attending Harvard University in the 1960s, Tarr launched a lucrative computer dating business. His secret today? He relies on sophisticated computerized risk analysis rather than takeover gossip. This helps him to project potential returns from specific deals. Look for Tarr again on next year's list. He brags that 1987's first quarter was one of his best.

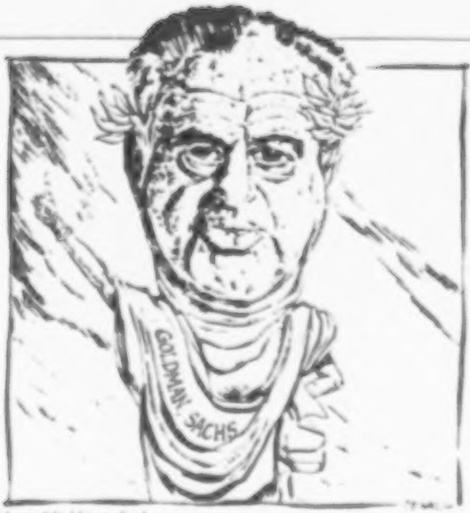
TRUST CO. OF THE WEST
Robert Day, Founder
Ernest Ellison, President and CEO

The 43-year-old grandson of millionaire William Keck, founder of Superior Oil Co., Robert Day comes from one of the richest families in America. He graduated from Claremont College, worked for the brokerage firm of White Weld & Co., then started the venture capital group Cypress Partners. Day started TCW, a Los Angeles-based money management firm, in 1971.

Ernest Ellison, 56, worked at Shareholders Capital Co.'s pension department and was investment chief of the California State retirement system before joining TCW in 1974. Last year the firm managed $11 billion worth of assets for over 130 clients. Day, who prefers to map out strategy, and Ellison, who handles day-to-day operations, each have a 25% stake in the firm and most likely raked in at least $7 million apiece in 1986. Day probably had additional earnings from other investments.

JOHN WEINBERG
Chairman and Senior Partner
Goldman, Sachs

The difficulties continue. Last year Weinberg faced the necessity of selling a 12.5% stake to Japan's Sumitomo Bank for $500 million. This year came the arrest of his arbitrage chief, Robert



John Weinberg of Goldman, Sachs

Freeman. Hard times for Weinberg, 62, who left Harvard in 1950 to join Goldman, then chaired by his father, Sydney, and became sole chairman in 1984. Goldman's current $2.4 billion of total capital still trails Salomon's and Shearson's, and a public offering is rumored. Ironically, Freeman's arbitrage work in large part helped Goldman to a record $750 million or more pretax, even after losses in bonds.

From his 5%-plus partnership share—the worth of which rose by $11.8 million or more last year—Weinberg reaped more than $4 million in cash distributions and salary. Total compensation: $15.8 million.

MALCOLM WEINER
Partner
Millburn Partners

A Harvard-trained former lawyer, Weiner, 52, posted a 6.86% loss through Sept. 30, 1986—the full year's tally isn't published—for clients of his giant, Connecticut-based commodities fund firm. What backfired? He and his partners wouldn't say. No doubt his arsenal of trend-tracking computers that govern trades slipped up in financial futures. Weiner's preferred instruments. Even so, this patrician connoisseur of Oriental art and crack chess player boasts only two losing years since 1973, when he began trading professionally. From his reported 85% share of management fees, on some $900 million of assets, Weiner earned about $14 million—after some $2 million of losses on his personal trading stake.

STEPHEN WEINROTH
Managing Director
Drexel Burnham Lambert

One of the architects of Drexel's corporate finance business, Weinroth, 48, now concentrates more on administration—a task that sources say earned him $5 million to $6 million last year. Among Weinroth's responsibilities: serving as chairman and CEO of Drexel's commercial paper subsidiary, heading a review committee for all underwriting and private placement of corporate deals, and, as of this year, overseeing Drexel's international investment banking activities—which he started. But Weinroth is keeping his hand in deal-making, too. Last May, he personally bought a 6.5% stake in Centronics Corp. of Nashua, N.H., from Control Data Corp. After the company's printer-related operations were sold to Genicom Corp. for $75 million, Weinroth sold his Centronics shares to the company for a $3 million to $5 million profit.

STEPHEN WEISS
Managing Partner
Weiss Peck & Greer

Stephen Weiss was just 34 years old when he launched his firm in 1970. Seventeen years later, Weiss Peck & Greer is a low-profile but prestigious house specializing in money management, with some venture capital and leveraged buyout efforts on the side. Now 51, this Cornell alumnus runs an outfit whose assets under management climbed from $3.1 billion to $3.4 billion during 1986. Today they stand at $4.7 billion. Last year's performance: up 10.6% in equities, 13.4% in balanced accounts and 16.8% in fixed income. But the star performer last year for WP&G, says Weiss, was its leveraged buyout operation.

Weiss' estimated one-third equity ownership in the firm probably earned him at least $6 million last year.

WESRAY CAPITAL CORP
William Simon, Chairman
Raymond Chambers, President

FW caught up with the former Treasury Secretary scuba diving off the Great Barrier Reef in Townsville, Australia. In a ship-to-shore conversation from his 125-foot yacht, Simon, 59, said he was managing to stay "one stroke ahead of the sharks." With partner Ray Chambers, 44, Simon also has some mighty jaws. The two, operating through the leveraged buyout firm of Wesray Capital Corp., gorged themselves on some sizable acquisitions last year. Among their hits: Outlet Co., bought for a reported $625 million; Avis Europe, for $284 million; and Simmons U.S.A. In June 1986 they realized some $32 mil-

Barry Ziskin of Z-Seven Fund

lion from the public offerings of two holdings: Lincoln Foodservice Products ($11 million) and Anchor Glass Container ($21 million). These days, Simon is a limited partner at Wesray, while Chambers handles day-to-day operations. But they both earned some $45 million to $50 million last year from the firm. Meanwhile, Simon's sights have shifted: He's busy buying ailing West Coast S&Ls.

WARD WOODS JR.
Partner
Lazard Freres

His expertise in energy and natural resources helped Woods, a 45-year-old native of La Jolla, Calif., in handling such M&A deals last year as French-based Air Liquide's $1.1 billion acquisition of Houston's Big Three Industries and Freeport-McMoRan's $750 million purchase of Petro-Lewis. For his part, Woods says he "gets involved in a wide variety of things" at Lazard Freres, ranging from handling M&A deals outside of the energy field to advising clients on such issues as strategic planning and corporate restructuring.

A Stanford University graduate, Woods came to Lazard Freres in 1978 after 10 years at Lehman Brothers. He was rewarded last year with $3 million to $4 million in compensation.

GUY WYSER-PRATTE
Executive Vice President
Prudential-Bache Securities

Unlike some of his peers, Pru-Bache's head of arbitrage continued to trade profitably during the months immediately following the Ivan Boesky insider trading scandal. As a result, the 46-year-old Wyser-Pratte was able to make about $5 million last year betting only on announced takeover bids, although he won't confirm specific deals. Chances are, though, he didn't stray much from the craft he learned from his father, Eugene, whose firm, Wyser-Pratte & Co., held a seat on the Paris Bourse in 1929.

Born and raised in Paris, Wyser-Pratte moved with his family to New York in 1947, when he was still a youngster. After serving as a captain in the U.S. Marines, he joined Prudential-Bache in 1966, one year before it bought his father's firm. Wyser-Pratte started off as an arbitrage research analyst and took over the entire department when his father retired in 1971.

ALBERT ZESIGER
President and Director
BEA Associates

When Zesiger purchased BEA Associates in 1969, it had only $60 million under management. Today it has $6.5 billion, with over $1.5 billion added in just the last year. With 29% of the firm, Zesiger earned $4 million in 1986, the next-largest earners being portfolio managers John Hurford and William Priest Jr., who both earned about $3 million. Their best performance came in fixed-income investments, up over 17%, while equities were ahead only 15% and balanced accounts rose 16%. Most of the equity portfolios include a plentiful supply of foreign securities, particularly Cementos Mexicanos (Mexico), FASA Renault (Spain) and Michelin (France), says Zesiger, 59, who also is astute in hedging and trading futures and options.

BARRY ZISKIN
President
Z-Seven Fund

His long hair and beard, Mesa, Ariz. base and lack of college sheepskin would seem to suggest the opposite of the model modern money manager. But not the $4.75 million that the 35-year-old pulled down last year. Ziskin manages $150 million in pension and private money as well as the Z-Seven closed-end mutual fund. Last year the fund's net asset value jumped 35.3%, while its stock price more than doubled. His 1986 compensation was generated from several sources, although the bulk of it came from appreciation in his own shares of the fund and the earnings from his firm, of which he is the sole owner. Ziskin, who bought his first stock with his bar mitzvah gift money, builds his investment philosophy around seven tests pegged to revenues, earnings, working capital, debt and price/earnings ratios. ●

Wall Street 100 Index

Rank	Name	Firm	Earnings ($mil)
1	**Michel David-Weill** (p. 39)	Lazard Freres	125
2	**George Soros** (p. 111)	Soros Fund Mgt	90 to 100
3	**Richard Dennis** (p. 39)	C&D Com	80
4	**Michael Milken** (p. 107)	Drexel Burnham	up to 80
5	**J. Morton Davis** (p. 39)	D.H. Blair	60 to 65
6	**Jerome Kohlberg** (p. 105)	KKR	50
	Henry Kravis (p. 105)	KKR	50
	George Roberts (p. 105)	KKR	50
9	**Raymond Chambers** (p. 113)	Wesray Corp	45 to 50
	William Simon (p. 113)	Wesray Corp	45 to 50
11	**Michael Steinhardt** (p. 112)	Steinhardt Part	40
12	**Edward Johnson III** (p. 43)	FMR Corp	35
13	**Jeffrey Tarr** (p. 112)	Junction Part	30
14	**Asher Edelman** (p. 40)	Plaza Securities	25 to 30
15	**Frederick R. Adler** (p. 34)	Adler & Shaykin	20
	Theodore Forstmann (p. 41)	Forstmann Little	20
	Leon Levy (p. 108)	Odyssey Part	20
	Jack Nash (p. 108)	Odyssey Part	20
19	**Donald Carter** (p. 38)	The Carter Org	16
20	**John Weinberg** (p. 112)	Goldman, Sachs	15.8
21	**Nicholas Forstmann** (p. 41)	Forstmann Little	15
	Bruce Kovner (p. 106)	Union Financial	15
	Brian Little (p. 41)	Forstmann Little	15
	Robert MacDonnell (p. 105)	KKR	15
25	**Malcolm Weiner** (p. 113)	Millburn Part	14
26	**B. Gerald Cantor** (p. 38)	Cantor Fitzgerald	11.3
27	**Keith Gollust** (p. 39)	Coniston Part	11
	Paul Tudor Jones II (p. 44)	Tudor Investment	11
	Paul Tierney (p. 39)	Coniston Part	11
30	**Thomas Dittmer** (p. 40)	Refco Group	10
	David Sanford Gottesman (p. 42)	First Manhattan	10
	Dean LeBaron (p. 106)	Batterymarch	10
33	**James Regan** (p. 109)	Princeton/Newport	8 to 9
	Edward Thorp (p. 109)	Princeton/Newport	8 to 9
35	**Leonard P. Shaykin** (p. 34)	Adler & Shaykin	8
	Bruce Wasserstein (p. 108)	First Boston	8
37	**Lucien Thomas Baldwin III** (p. 36)	Baldwin Com	7 to 10
38	**George Kellner** (p. 105)	Kellner DiLeo	7 to 8
39	**Robert Day** (p. 112)	TCW	7
	David Dreman (p. 40)	Dreman Value Mgt	7
	Ernest Ellison (p. 112)	TCW	7
	Augustus Oliver (p. 39)	Coniston Part	7
	David Schafer (p. 110)	Schafer Capital	7
	Philip Straus (p. 108)	Neuberger & Berman	7
45	**Geoffrey Boisi** (p. 36)	Goldman, Sachs	6.5 to 9.7
	Stephen Friedman (p. 41)	Goldman, Sachs	6.5 to 9.7
	James Gorter (p. 36)	Goldman, Sachs	6.5 to 9.7
	H.F. Krimendahl (p. 105)	Goldman, Sachs	6.5 to 9.7
	Richard Menschel (p. 107)	Goldman, Sachs	6.5 to 9.7
	Robert Mnuchin (p. 107)	Goldman, Sachs	6.5 to 9.7
	Robert Rubin (p. 41)	Goldman, Sachs	6.5 to 9.7
52	**Alan Greenberg** (p. 42)	Bear, Stearns	6
	Leonard Heine Jr. (p. 43)	Management Asset	6
	Felix Rohatyn (p. 109)	Lazard Freres	6
	Marvin Schwartz (p. 108)	Neuberger & Berman	6
	Stephen Weiss (p. 113)	Weiss Peck & Greer	6
	Lawrence Zicklin (p. 108)	Neuberger & Berman	6
58	**Albert Cohen** (p. 108)	Neuberger & Berman	5.5
59	**G. Chris Andersen** (p. 34)	Drexel Burnham	5 to 10
60	**Richard Isaacs** (p. 43)	DLJ	5 to 8
61	**Herbert Bachelor** (p. 34)	Drexel Burnham	5 to 6
	Joseph Perella (p. 108)	First Boston	5 to 6
	Stephen Weinroth (p. 113)	Drexel Burnham	5 to 6
64	**Arnold Amster** (p. 34)	Lafer Amster	5
	Leon Black (p. 36)	Drexel Burnham	5
	Maurits Edersheim (p. 40)	Drexel Burnham	5
	Daniel Good (p. 42)	Shearson Lehman	5
	Max Heine (p. 43)	Heine Securities	5
	Robert Johnston (p. 44)	Beacon Hill Fin	5
	Frederick Joseph (p. 44)	Drexel Burnham	5
	John Kissick (p. 105)	Drexel Burnham	5
	A. Brean Murray (p. 108)	Brean Murray	5
	Fayez Sarofim (p. 110)	Fayez Sarofim	5
	Guy Wyser-Pratte (p. 114)	Prudential-Bache	5
75	**Barry Ziskin** (p. 114)	Z-Seven Fund	4.75
76	**Roy Neuberger** (p. 108)	Neuberger & Berman	4.5
77	**Peter Cohen** (p. 38)	Shearson Lehman	4
	Damon Mezzacappa (p. 107)	Lazard Freres	4
	Howard Rubin (p. 110)	Merrill Lynch	4
	Martin Shafiroff (p. 111)	Shearson Lehman	4
	Albert Zesiger (p. 114)	BEA Associates	4
82	**Donald Marron** (p. 106)	PaineWebber	3.8
83	**Scott Black** (p. 36)	Delphi Mgt	3.5 to 4
84	**Charles Royce** (p. 110)	Quest Advisory	3.5
85	**Richard Schmeelk** (p. 111)	Salomon	3.4
86	**Peter Buchanan** (p. 38)	First Boston	3.2
87	**John Gutfreund** (p. 42)	Salomon	3.1
	Alvin Shoemaker (p. 111)	First Boston	3.1
89	**Julian Robertson** (p. 109)	Tiger, Jaguar, Puma	3 to 6
90	**Eric Gleacher** (p. 42)	Morgan Stanley	3 to 5
	Louis Perlmutter (p. 109)	Lazard Freres	3 to 5
	Alan Slifka (p. 111)	Halcyon Inv	3 to 5
93	**Philip DiLeo** (p. 105)	Kellner DiLeo	3 to 4
	Richard Fabian (p. 41)	Tel. Switch Nwsltr	3 to 4
	J. Tomilson Hill (p. 43)	Shearson Lehman	3 to 4
	Leo Melamed (p. 106)	Dellsher	3 to 4
	Stephen Waters (p. 43)	Shearson Lehman	3 to 4
	Ward Woods Jr. (p. 114)	Lazard Freres	3 to 4
99	**Stephen Joseph** (p. 44)	Drexel Burnham	3
	David Kay (p. 36)	Drexel Burnham	3

STATEMENT BY WILLIAM H. WYNN
PRESIDENT, UNITED FOOD AND COMMERCIAL WORKERS INTERNATIONAL UNION
FOR THE HEARINGS OF
THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
CONCERNING CORPORATE MERGER, ACQUISITION AND TAKEOVER LEGISLATION
July 14, 1987

I testified before you and your Committee on April 8 concerning the very sad experience which the UFCW and tens of thousands of its members have had because of the merger mania in the retail food industry. I spoke at length about the job losses and the reductions in wages and benefits which workers have suffered because of the retail takeover speculations and the efforts to fight takeovers.

The UFCW and its members had high hopes that the Committee and the Congress would write legislation which would stanch the takeover excesses. In fact, we suggested some major and minor proposals in our testimony.

Unfortunately, we have been disappointed. Legislation which you and other members of the Committee introduced (S.1323) did indeed incorporate some of the minor proposals which make the takeover battles somewhat fairer. They do slow down actual takeover fights and provide some opportunities for protection and benefit to shareholders.

However, S.1323 does little to protect workers or the communities in which they work and live. the bill simply does nothing meaningful about the financial aspects of the takeover fights. The bill does not change the fact that a raider currently risks little in a takeover attempt and can make immense amounts of money whether he achieves control of the corporation or not.

S.1323 neglects the fact that workers and communities suffer as soon as a company comes into play. Whether management wins or the raider wins means comparatively little to their interests. The winners -- whoever they are -- will have created a huge corporate debt. That debt will be reduced by the closing of corporate divisions or units and by blackmailing employees into givebacks of wages and benefits.

Workers and communities lose jobs! The standard of living is lowered for tens of thousands of poor and moderate income families!

Mr. Chairman and Members of the Committee, these families look to you for help against a phenomenon over which they can have no control and which they do not even understand. These people and their communities will not be helped by making the playing field a little more even between existing management and the raiders nor will they be aided much by making insider trading somewhat more difficult to accomplish. They will not be helped by making the process somewhat more fair to stockholders. They need stronger medicine.

The UFCW therefore urges your favorable consideration of S.1324 introduced by Sen. Terry Sanford. The bill is no panacea, but unlike S.1323, it does deal with some of the financial aspects of takeover efforts that wreak such great havoc among employees and communities.

S.1324, for example, does address the problem of a raider not having to risk anything by putting a company into play. In contrast to the raider's current "win-win" situation, S.1324 would require the return of short term profits to the company from any failed takeover attempt.

S.1324 prohibits the so-called "in place/confidence" letters. It requires a raider to have financing ready before he makes a tender offer. It also prohibits hostile takeovers in which more than 25 percent of the financing is secured against the target company's assets.

S.1324 prohibits the two tier tender offer. A takeover group must offer stockholders the purchase of all their stock instead of a percentage.

S.1324 provides for fairness in leveraged buyouts. It provides regulatory assistance against any self-dealing transactions.

S.1324 requires an economic impact statement that is absolutely vital to employees and their communities. It would tell employees —as the acquirer has already told his prospective financial backers— which group will retain jobs and which will lose them. It also would provide a variety of financial information to the communities before they suffer wrenching economic dislocations. As a result, both the employees and the communities may be able to plan for their future in the new environment before disaster strikes.

The UFCW urges that you add another important protection for workers, businessmen and communities which is unfortunately not contained in S.1324. Contracts with workers and businesses, such as suppliers, purchasers, creditors and debtors which the corporation voluntarily entered into must remain binding on any new owners for the time of the original term of the agreement. It is ridiculous --as well as harmful-- that otherwise valid contracts can be turned into scraps of paper by a corporate reorganization. The sanctity of a legal contract should be preserved.

Mr. Chairman and Members of the Committee, it is time to stop pussyfooting around the great dangers and great harm which the merger mania is causing to American workers and communities. The UFCW urges you to approve legislation similar to S.1324, as well as the minor reforms of S.1323. In addition, we respectfully, but strongly, urge you to assure the sanctity of contract by requiring new owners to adhere to the terms of existing contracts.

As I told you in April, the UFCW does not oppose mergers or the takeover of corporations, but we do insist that employees and their communities --the innocent bystanders in the corporate wars-- have some meaningful protection against harm and suffering. We hope you will accomplish that very important goal.

Mr. James K. Baker
Chief Executive Officer
Arvin Industries, Inc.
1531 13th Street
Colombus, IN 47201

SUPPLEMENTAL QUESTION FOR MARCH 4, 1987 HEARING RECORD
FROM SENATOR WILLIAM PROXMIRE

It has been alleged that nowadays a company can be "put into play" without an acquiror having to put up any real money. Is this in fact the case, and could you give us an example of this? What should be done to ensure that bidders put up some of their own money in these deals?

Yes, in fact a company on whose Board I sit was put in play by a group announcing that they were considering a bid and had requested a meeting with officials of the company. At that point "we were in play."

I dont have a practical solution, but if it was illegal for a potential acquiror to make (or leak) such statements, then having done so, require a 120-day cooling off period. Arbitrajeurs do not like to invest in "long"-term hedges.

JKBaker

THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER

HARRISON J. GOLDIN
COMPTROLLER

July 9, 1987

Honorable William Proxmire
Chairman
Committee on Banking, Housing
and Urban Affairs
Room SD-534
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Proxmire:

I appreciated the opportunity to comment on the corporate takeover legislation your Committee is considering. You invited me to expand on my concerns about some of the language in the Tender Offer Disclosure and Fairness Act of 1987 (S. 1323).

As an institutional shareholder and co-chair of the Council of Institutional Investors I am particularly concerned about the definition of a "person" in Section 5 of the bill. Inadvertently, I believe, the language could preclude such groups as the Council from meeting to disseminate information of considerable importance and value to members and their beneficiaries.

This risk could be avoided through greater specification of the activities "persons" are prohibited from engaging in without disclosure and reporting. I suggest that to the proposed requirement in the bill for filing with the Securities and Exchange Commission when two or more persons agree to act together "for the purpose of acquiring, holding, or disposing of securities" the words "or voting" be substituted for "influencing the management or policies of an issuer." This suggestion is consistent with the SEC's interpretation of Section 13(d)(5) of the Securities Exchange Act of 1934, as set forth in Regulation Section 240-13d-5.

Groups like the Council should be able to seek to influence the management or policies of an issuer through meaningful dialogue, without each member having the burden of a Schedule 13D filing with the SEC. Only when management does not respond to concerns raised by shareholders and they decide to act in a concerted manner in the acquisition, holding, disposition or voting of securities should the filing of a Schedule 13D be required.

The Council of Institutional Investors met recently with senior management of the General Motors Corporation to express concern about the value of the company's stock. Subsequently, to increase the market value of its common stock, General Motors agreed to buy back up to 20% of its outstanding shares. Had the Council's attempt to influence the policies of General Motors necessitated the filing of a Schedule 13D, this important meeting would have never taken place; thousands of individual General Motors shareholders would have been denied the value of the buy-back.

This is only one example of how an organization like the Council can benefit all shareholders. Indeed, as I indicated in my testimony, and as my staff explained during the meeting you kindly held with Council members later in the day, institutional shareholders can have even greater positive effects on the management of companies if we--and all other shareholders--are granted some elementary rights of corporate citizenship.

I enclose a copy of the Shareholder Bill of Rights the Council issued last year. It is a blueprint for corporate democracy by which we believe all publicly-held companies should be bound. Your Committee would perform a great public service by including these principles in any legislation that regulates corporate activities.

I would, of course, be happy to discuss these matters further with you or the Committee staff.

Sincerely,

Enclosure

Greenhill Responses to 6/24/87 Questions of Senator D'Amato

Q.1. One of the most constant criticisms of corporate takeovers is that they have resulted in the over-leveraging of America. What is your response to those who claim that corporate debt levels have risen to dangerous levels and that corporate restructurings have had no benefits for the American economy?

A.1. It is virtually impossible to determine an optimum level of corporate debt. The level of corporate debt is unique to every company and is influenced by many interrelated factors. In fact, studies have shown that leverage may increase corporate efficiency and thus be preferable to equity in terms of financing a business. See, e.g., Jensen, Agency Costs of Free Cash Flow, Corporate Finance and Takeovers, The American Economic Review, Vol. 76, No. 2, at 323 (May 1986). Also, leveraged buy-outs, that have high levels of debt, have been extremely successful and have increased efficiency. See, Zonana, "New Owners Turn Around Hopeless Operations; Cashing in on Corporate Castoffs", Los Angeles Times, December 2, 1985, Part 4, at 1.

Corporate restructurings have had a beneficial effect on the American economy. America's principal economic problem today is not the alleged over-leveraging of America, but rather its faltering competitiveness. Corporate management has been unable and/or unwilling to change corporate structures and strategies to meet challenges from abroad. The takeover activity that has occurred in recent years has facilitated necessary restructuring and has spurred management to streamline operations in an effort to make their companies leaner and more competitive. Morgan Stanley has published a recent report that has demonstrated that industries which have had the greatest restructuring have also had the greatest increase in productivity and competitiveness. Paulus and Gay, Is America Helping Herself? Corporate Restructuring and Global Competitiveness, Worldwide Economic Outlook 1987, Morgan Stanley, at 14-21 (1987). This process is critical to enable American companies to become more productive and create more jobs for American workers.

Q.2. Another criticism of takeovers was voiced by Dr. Alan Greenspan and Lloyd Cutler who noted that the equity decapitalization of American industry is running at the order of $70 to 80 billion a year on a base of roughly $1 trillion of book equity capital of all financial business corporations.

a) What is the relevance of these figures and why should we be concerned about this equity decapitalization?

b) Isn't the real issue regarding equity decapitalization whether the cost to a corporation of financing debt more or less expensive than the costs of carrying equity on the company's books?

c) In the current economic environment, would it be wiser to carry more debt or equity on a company's books?

A.2. It is impossible to generally state that either debt or equity financing is preferable or wiser, or that American industry depends too much on one or the other. As discussed above, the optimal debt-equity ratio is unique to every company and is influenced by many interrelated factors. Included are the economy, interest rates, tax laws, government regulation, inflation, management, industry segment and competition. The debt-equity ratio of every company will reflect these and other factors and will vary, sometimes greatly, at different times.

Q.3. Critics of corporate takeovers also claim that they are merely "paper transactions" that create no wealth. They claim, that shareholders and corporations realize no net economic gains from corporate takeovers.

a) If this is true, then don't the same criticisms apply to negotiated mergers and leveraged buy-outs as well as hostile takeovers?

b) The real issue than is: do these transactions create value or do they simply redistribute wealth from one stockholder group to another?

c) Can you supply us with any empirical evidence suggesting that any real wealth has been created by corporate takeover activity? I ask this question because Senator Proxmire constantly cites a study conducted by Professor Lowenstein at Columbia University to support the position that takeovers, especially hostile takeovers, are not value-creating or value-increasing transactions. Are there any studies of which you are aware that take issue with the Lowenstein study and could you provide them to the Committee?

A.3. The criticism that corporate takeovers are merely "paper transactions" that create no wealth is not valid. In the aggregate, gains from corporate takeover activity are significant due to the expectation that two businesses will operate more efficiently together than they do separately. Such gains in efficiency translate into greater tax revenues, greater productivity and more potential for growth. For a discussion of how takeovers and mergers generate net benefits to the economy, see Economic Report of the President, Feb. 1985, at 198; Fisher and Lande, Efficiency Considerations in Merger Enforcement, 71 Calif. L. Rev. 1580, 1583-4.

Q.4. Another criticism of takeovers has been that they result in job loss. Can you cite any empirical evidence that, in the aggregate, corporate takeovers have had a positive, rather than negative, impact on job creation?

A.4. It is clear that certain transactions have resulted in some job losses. We are very sympathetic to this problem and are not ignoring it. As the American workforce is the backbone of American industry, any impediment to the worker will have a negative effect on our economy.

We believe, though, that when considered together, mergers and acquisitions have had a positive effect on the American economy. By making businesses more competitive, these transactions will ultimately benefit American workers in the future.

There is a growing body of empirical evidence that mergers and acquisitions may help to save plants that are in danger of closing. The United States General Accounting Office ("GAO") recently published a national survey of over 2,000 businesses which experienced a plant closure or layoff during 1983 and 1984. The report concluded that the major reasons for closures or layoffs were not related to bankruptcy or financial reorganization, but to problems of competition in the marketplace: reduced product demand, increased competition, high labor costs, low productivity, poor management, and facility obsolescence. The GAO noted that only 7% of the businesses surveyed had experienced any kind of financial reorganization (including bankruptcy), and there was no suggestion that financial reorganization was a cause of any closure or layoff. See also, Jensen, Takeovers: Folklore and Science, Harv. Bus. Rev., Nov.-Dec. 1984; Yago, Economic Research Bureau, State University of New York at Stony Brook, Plant Closings in New York: Causes, Consequences, and Policy Implications (Jan. 1986).

Q.5. Corporate takeovers have also been criticized because they discourage long-term planning and research and development by corporations. Critics of takeover activity argue that American companies are leveraging their futures to pay out shareholders today at the expense of growth tomorrow. How do you respond to these claims -- are corporate takeovers being used as a scapegoat by American managers for their failure to remain competitive with their foreign counterparts?

A.5. A recent article has concluded that the threat of hostile takeovers has not reduced corporate spending for research and development. The American Banker, December 17, 1986 at p.4. The article cited a study by management expert Peter Drucker which found that hostile takeovers really began in 1980. Contrary to the view that the threat of hostile takeovers has induced management to boost short-term profits at the expense of spending on research and development, Drucker found that business-financed research and development rose 34% after inflation between 1980 and 1985. Between 1970 and 1975, when there were virtually no hostile takeovers, it grew only 7%. The report also found that business investment, as a proportion of gross national product, has been about 10% higher in the 1980's than it was a decade earlier.

The article added that managers are being forced to focus on long-term goals due to increased competition and other factors, and not the threat of takeovers. To remain competitive, American companies must formulate business plans that will lower costs, improve quality and develop new products.

Q.6. The motives of those engaging in contests for corporate control have been questioned. Senator Sanford demonstrated this skepticism yesterday and at a January 28, 1987 hearing where he stated: "I have not seen any crusaders going around the country trying to improve management in the various corporations that have turned out to be takeover targets. I don't think that's motivation at all."

a) As an expert in this area, what criteria are employed to determine the companies that are ripe for a takeover?

b) For instance, in the Burlington Industries/ Edelman/Morgan Stanley takeover battle, what made Burlington susceptible to a takeover bid?

A.6. The bottom line motive of any takeover is the belief that the bidder has a better strategy for using the assets of the company. Frequently, this includes selling off non-core businesses which the target has not been able to manage effectively and which decrease the profitability of the company. This process of streamlining and restructuring, as mentioned above, has been good for industry and the economy as a whole.

Many factors are considered when analyzing a company, including Burlington Industries, with a view towards making a tender offer. Included are whether the acquisition would promote efficiency, increase shareholder wealth, improve competitiveness, increase the potential for growth, make management more effective, allow for better response to changes in technology and consumer preferences and increase profits. The weight accorded each of these factors and others are unique to each company.

Q.7. In general, are the bust up takeovers we have witnessed in recent years the result of the failed conglomerate mergers of the 1970's? After all, study after study, including the Ravenscraft and Scherer study cited yesterday by Senator Sanford, concluded that conglomerates performed poorly in the mid to late 70's. Thus, isn't the market working to improve the efficiency of those corporations that grew to satisfy the egos of managers rather than to maximize the interests of the company's shareholders and to improve the company's competitiveness?

A.7. Restructurings and corporate takeovers are merely part of a continuing process to meet competition and other factors, and not solely the result of failed conglomerate mergers. Each generation of corporate managers must be willing and able to stay competitive, especially to meet the challenges from abroad. Most economists agree that the latest wave of takeovers is a natural by-product of substantial changes in competitive conditions in U.S. and world economies. This is demonstrated by the fact that most of the merger and acquisition activity over the past six years has occurred in industries, such as petroleum, finance and manufacturing industries, which have been forced to adapt to new conditions such as deregulation or increased foreign competition. Poulsen & Jarrell, supra; Paulus & Gay, supra at 15; The Journal of Commerce, Jan. 7, 1987.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE COMMISSIONER

August 25, 1987

The Honorable Alfonse D'Amato
United States Senate
SH-520 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator D'Amato:

In response to your letter of June 1, 1987, addressed to former Chairman Shad, please find attached responses to the questions which you and Senator Garn raised.

Attachment A is a copy of a letter of June 24, 1987 from Gary Lynch, Director of the Division of Enforcement, ("Lynch letter") to Chairman William Proxmire of the Senate Committee on Banking, Housing, and Urban Affairs. That letter contains responses to a series of questions asked Mr. Lynch on your behalf by Chairman Proxmire. Questions and answers 1-6 in the Lynch letter correspond to questions 1-6 under the caption "Insider Trading" in your letter of June 1; questions and answers 11 and 12 in the Lynch letter correspond to "Insider Trading" questions 7 and 8, respectively; and question and answer 13 in the Lynch letter contains the response to both questions 2 and 3 under the caption "Takeover Reform-Amendments to the Williams Act."

Responses to your remaining questions are found at Attachment B and are numbered in conformity with the numbers assigned to them in your June 1 letter. Responses to Senator Garn's questions are at Attachment C.

Sincerely yours,

Charles C. Cox

Charles C. Cox
Commissioner

ATTACHMENT A

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
ENFORCEMENT

June 24, 1987

The Honorable William Proxmire
Chairman, Committee on Banking,
Housing and Urban Affairs
United States Senate
Washington, D.C. 20510-6075

Dear Chairman Proxmire:

I have enclosed my responses to the questions from Senator D'Amato enclosed with your letter to me of April 27, 1987 to supplement the record of the hearings held before your Committee on April 22, 1987.

I would be pleased to furnish any additional information which the Committee may request.

Sincerely,

Gary Lynch
Director

Enclosures

cc: The Honorable Alfonse M. D'Amato

Q. 1. In 1984, the Insider Trading Sanctions Act, which I sponsored, was enacted. The legislation was designed to provide an effective deterrent to insider trading by increasing the penalties from disgorgement alone to disgorgement plus a civil penalty of up to three times the amount of the profits gained or losses avoided. Although the Insider Trading Sanctions Act was intended to be a deterrent, some of the largest and most egregious insider trading cases have been prosecuted since that time.

(a) In light of the recent prosecutions, do you believe that the civil sanctions imposed by the Insider Trading Sanctions Act need to be increased?

A. I believe that the civil penalties provided by the Insider Trading Sanctions Act ("ITSA") are adequate at their current level. While the Commission has yet to litigate to a conclusion an insider trading case in which a treble penalty is requested, the Commission has determined to accept a payment ranging from a one-time to two-time penalty in settlement of actions which have been brought. These payments, some of which have been very large, accomplish the deterrent purposes of the securities laws insofar as civil penalties can achieve those purposes.

(b) Do we really need more severe civil and criminal penalties (5 years and $250,000 fine for each criminal securities law violation) or do we need more cops on the beat to provide a more effective deterrent?

A. For an economic crime such as insider trading, the deterrent effect of enforcement is a function of the probability that a violator will be apprehended and the severity of the sanction that will be imposed. As I indicated in my answer to the preceding question, I believe that the current civil sanctions are adequate. With respect to criminal sanctions, I would note that all of the defendants in insider trading cases have received less than the maximum penalty provided by statute. I would therefore conclude that the current level of deterrence could best be increased by devoting more resources to the surveillance, investigation, and prosecution of insider trading offenses. However, I personally would support legislation which would increase criminal penalties or provide for mandatory jail sentences.

(c) As you know, I have introduced legislation attempting to define insider trading. Pursuant to my attempts, Senator Riegle has asked a panel of securities law experts, including two of this Committee's counsels, to formulate a definition of insider trading. Do you believe that a carefully crafted definition of insider trading could facilitate your enforcement efforts - especially with regard to your ability to bring close cases such as the Foster Winans case? Could you briefly explain your theory of the case and why Winans' alleged violations constitute insider trading?

A. As I stated at the hearing on April 22, while I do not believe that the current law is vague or uncertain, I believe that a carefully crafted definition of insider trading could facilitate the Commission's enforcement efforts. It would be necessary to carefully examine any proposed definition, however, to ensure that it would not create loopholes or increase the burden of proof which the government must satisfy in insider trading cases.

With respect to the Winans case, the Commission's complaint alleged that Winans profited by communicating material, nonpublic information (i.e. the substance and timing of the Wall Street Journal's forthcoming newspaper columns) to the other defendants. The communication of this information violated Winans' duty of trust and confidence to his employer, enabled Winans and his confederates to derive substantial profits, and constituted a fraud that was perpetrated "in connection with" the purchase of securities.

(d) What specific additional steps would you recommend to crackdown on insider trading?

A. It will be necessary to devote substantial resources to conclude the current investigations and any additional cases which flow from them. Prospectively, the Commission and the self-regulatory organizations must continue to improve their surveillance procedures and investigative efforts.

Q. 2. Some commentators have suggested that illegal trading activity will not be stymied until really harsh criminal penalties are imposed on inside traders. How do you respond to those who claim that the civil and criminal penalties imposed upon Levine, Boesky and Siegel, et al. were too lenient? How do you determine (i.e. what factors) the adequacy of the jail sentences which were imposed in these cases since none of these men ever stood trial? If you find during subsequent investigations that any of the individuals involved in the cases which have settled have failed to tell the whole truth, what recourse do you have against them?

A. I believe that the civil disgorgement and fines imposed upon Levine, Boesky and Siegel are at least as large as we would have obtained had we litigated the cases to a successful conclusion. The defendants will also be subjected to multiple private actions for damages.

With respect to the criminal sanctions, only Levine has been sentenced at the present time. The sentencing judge was very specific in stating that the sentence imposed on Levine (two years imprisonment plus a fine of $362,000) would have been larger but for Levine's cooperation with authorities. All settlements, whether civil or criminal, reflect a cost benefit judgment. An accurate assessment of the benefits which the government received from the defendants' cooperation will be possible only after the current investigations have concluded.

The settlement with each of these defendants required that they make complete and accurate disclosure of all information which they possessed concerning insider trading violations or any other type of securities violation. If it is subsequently determined that they have willfully withheld or falsified information, they lose the benefit of their settlement agreement and may be prosecuted for their participation in the undisclosed violations as well as for all the conduct which they have revealed to the Commission. They may also be prosecuted for making false statements to a department or agency of the United States in violation of 18 U.S.C. 1001. Thus, there are strong incentives for a cooperating witness to be completely truthful and candid.

Q. 3. An SEC Office of Chief Economist Study entitled Stock Trading Before the Announcement of Tender Offers: Insider Trading or Market Anticipation concludes that the increase stock prices and trading volumes of target shares before a takeover announcement are due to a number of factors that have nothing to do with illegal insider trading. Do you agree with the findings of this report or do you believe that insider trading is the dominant source of information that spurs a runup in a stock's price before the announcement of a takeover bid?

A. It is extremely difficult to isolate the factors which cause price and volume increases in a stock prior to a takeover announcement. I tend to agree with the study's conclusion that many such increases are caused by such factors as a prospective bidder's legal accumulation of shares up to the five percent threshold, trading on the basis of speculation and rumor, and trading by persons who react to the technical performance of a stock. Once a stock that has been the subject of speculation begins to move, it tends to acquire momentum because many people conclude that the movement reflects the existence of an unannounced corporate development. However, it is apparent that in numerous instances insider trading contributed at least in part to a runup in stock price prior to a takeover announcement.

Q. 4. Do you believe that lowering the Schedule 13D reporting acquisition threshold from 5% to 3% or lower could have any impact on the incidence of insider trading?

A. Although legislation to lower the Schedule 13D reporting threshold might be useful for other purposes, it should not be assumed that such legislation would have a significant impact on the incidence of insider trading. Agents of a prospective bidder could leak nonpublic information prior to reaching a three percent threshold just as easily as they can now leak such information prior to reaching a five percent threshold. Reducing the reporting deadline from the current ten day period would probably have a greater impact, because it would limit the length of time during which persons could take advantage of nonpublic information.

Q. 5. The first line of defense against insider trading should be the in-house policies and procedures of firms that regularly engage in securities transactions. My perception of these in-house, self-policing mechanisms is that they are illusory and these firms are paying lip service to their commitment to eradicate insider trading. I have introduced legislation that would, under certain circumstances, impose civil penalties upon firms for an employee's violations of the federal securities laws. Do you believe that these firms would have a greater incentive to formulate and implement self-policing mechanisms if the firm was civilly liable for the actions of their employees if they knew or should have known that their employees were trading on inside information? What, if any, provisions of the law permit the SEC to prosecute firms for the actions of their employees? What are the limitations of these laws regarding your ability to prosecute a firm?

A. Legislation which imposed civil penalties upon firms for an employee's violation of the securities laws would undoubtedly provide an incentive to implement and maintain supervisory procedures. Those firms already have substantial incentives, however, and it should be recognized that there is a limit to any firm's ability to prevent one of its employees from violating the law. For example, Dennis Levine took elaborate steps to conceal his illegal trading activity from his employers.

In recognition of the limits upon a firm's ability to detect violations, any proposed legislation should not impose strict liability upon firms for the violations of their employees. Rather, I believe that liability should be imposed only upon a showing that the firm knew, or should have known, of the employee's violations.

At the present time, the Commission may administratively sanction firms for failing to exercise reasonable supervision over its employees with the view to preventing violations. The Commission has brought failure to supervise cases on a regular basis against both large and small firms. However, in the past these cases have concerned violations other than insider trading.

The Commission may also seek civil penalties under ITSA where the trading is effected in a proprietary account of the firm. In SEC v. The First Boston Corporation, Civ. No. 86-3524 (S.D.N.Y. 1986) and SEC v. Kidder, Peabody & Co., Inc., Civ. No. 87-3869 (S.D.N.Y. 1987), the firms were required to disgorge their illegal profits and pay a civil penalty equal to twice the size of those profits subject to the ITSA penalty. Where an employee trades for his own account, however, it is unclear whether a civil penalty may be imposed against the firm. ITSA provides that a defendant may be held liable for aiding and abetting a violation only if the defendant communicated the nonpublic information to the person who traded.

Q. 6. Since 1981, what percentage of the insider trading cases which have been successfully brought or settled by the SEC have involved market professionals such as investment bankers, investment professionals and broker dealers and what percentage have been brought against corporate officers and directors and their friends and relatives?

A. To respond to this question, the staff reviewed the litigation releases relating to all insider trading cases brought by the Commission in its fiscal years 1981 through 1986. Based upon this review, it is estimated that 52% of the cases involved corporate officers and directors or their friends and associates; 16% involved securities professionals; 13% involved individuals from both groups; and 19% involved individuals in other occupations (e.g., financial printers, law firm employees, and accountants).

It should be noted that the Commission typically brings administrative proceedings, in addition to injunctive actions, against securities professionals who engage in insider trading. Such administrative proceedings are not reflected in the estimates set forth above.

Q. 7. Recently, the New York Stock Exchange, the American Stock Exchange and the NASD have publicized their efforts to increase market surveillance. What role does the SEC play with regard to coordinating the market surveillance activities of the self-regulatory organizations? What percentage of the insider trading cases brought by the SEC since 1981 have been initiated by the SEC's market surveillance efforts? What percentage of these cases have been brought due to the market surveillance activities of the self-regulatory organizations? How effective are the market surveillance activities of the self-regulatory organizations in detecting insider trading or other illegal trading activity - in short, do these expensive and elaborate technological detection systems really work?

A. The Commission maintains an active oversight program of the self-regulatory organization ("SRO") surveillance systems. This oversight involves both on-site inspections as well as participation by the Commission's staff in efforts to coordinate and improve SRO activities through the Intermarket Surveillance Group ("ISG"). Just recently, for example, the Commission staff assisted the ISG in developing goals and procedures to expedite insider trading referrals from the SROs to the Commission. Generally, Commission inspections have revealed that SRO systems are effective in detecting aberrant trading that might involve insider information, but that the SROs could improve the speed and quality of their investigations of such aberrant trading. The SROs have been responsive in addressing these concerns.

The information provided by an SRO or any other source varies from case to case. In many cases, it consists of nothing more than the names of various persons who purchased a particular security prior to announcement of material news. Sometimes, however, it may include an analysis of a pattern of trading, or evidence of possible relationships between insiders and the persons who purchased or sold the security in question.

As with other types of cases, insider trading cases originate from various sources. Some insider trading cases, for example, originate from complaints or information provided by members of the public. Others are derived from information uncovered in financial fraud cases. Finally, many such cases originate from more than one source. For these reasons, it is difficult to provide precise estimates concerning the source of these cases. Based on a review of insider trading cases brought in the last three fiscal years, however, we estimate that at least 40% of them were based on information provided by an SRO. Information generated by Commission efforts was also a source in approximately 40% of the cases during that period.

Q. 8. Under the current system of detection, is it more difficult to detect the institutional investor who sporadically trades on inside information or the person who trades illegally on a one shot basis? If it is harder to detect the sporadic institutional trader, are special steps being taken to detect his illegal trades?

A. As I noted in my prepared statement, persons who engage in insider trading rarely confess to their crime. The Commission generally brings its cases after accumulating circumstantial evidence that the defendant did in fact possess inside information at the time of his transaction. Where a person engages in insider trading on an isolated basis, it is often possible to argue that an inference should be drawn that the transaction was motivated by inside information because it deviated from the person's trading history. Where a person with no prior experience in the market opens a new account and buys very speculative options, for example, the inference that such person possessed nonpublic information is compelling. A strong inference may also be drawn where a transaction is unusually large in relation to the individual's assets and income.

It is generally more difficult to build a circumstantial case against a professional trader who is continuously in the market. The illegal transactions may not differ in size from the professional investor's normal pattern of trading. Moreover, the professional investor is usually prepared to provide a sophisticated description of factors (other than inside information) that motivated the transactions under investigation.

One step that is being taken to detect insider trading by market professionals is to modify surveillance procedures so that repetitive suspicious trading is detected. Many of the cases brought against professional traders have involved transactions in several different securities. Such cases were developed only after the pattern of insider trading in more than one stock was detected. In such cases, an analysis of the investment banking and law firms involved in the various transactions has allowed the Commission to isolate the source of the trader's information.

Q. 9. Were the trades of Dennis Levine and Ivan Boesky ever identified by the SEC's or SRO's surveillance systems? If so, on how many occasions?

A. Because Dennis Levine traded through an account at Bank Leu International, Limited, a Bahamian subsidiary of a Swiss bank, his identity was not revealed by surveillance systems. Of the 54 securities which Levine was alleged to have purchased while in possession of inside information, self-regulatory organizations provided surveillance reports to the Commission concerning transactions in 24 of the securities. In most instances, these reports merely identified Bank Leu as one among many purchasers prior to the public announcement of the transaction in question. The attached memorandum describes what action the Commission took with respect to such surveillance reports (Attachment A).

With respect to trading by Ivan Boesky, the New York Stock Exchange reviewed trading by Boesky or his entities on at least 26 occasions between 1984 and 1986. Ten of those matters are under investigation by the NYSE. With respect to the 16 surveillance reports received by the Commission, investigations were opened in at least 14 matters. It should be noted that the NYSE did not refer any investigations due to Boesky's trading.

Q. 10. We have heard that insider trading cases are very difficult to prove. What are the principal problems confronting your efforts to prosecute inside traders? As enforcers and prosecutors could you recommend any legislation which could facilitate your efforts to enforce the laws currently on the books? Should the SEC be allowed to bring criminal as well as civil actions?

A. As I noted in my prepared statement, the most difficult problem which the Commission faces in insider trading cases is building a circumstantial case against persons who do not have to create incriminating documents and who are prepared to commit perjury when questioned under oath. In order to alleviate these problems, it is necessary to aggressively prosecute individuals for perjury and obstruction of justice as well as insider trading. I do not believe that it is necessary to provide the Commission with authority to bring criminal actions. The current level of cooperation with the Department of Justice and the various U.S. Attorneys is excellent and insider trading cases that warrant criminal prosecutions are being pursued.

Q. 11. a) As a result of the increasing internationalization of the securities markets, shouldn't we be focusing on the real threat to our system posed by insider trading which is transactions executed in our securities on overseas markets?

A. The Commission's enforcement program primarily focuses upon detecting and investigating alleged insider trading which occurs on the U.S. markets. In cases where insider trading on a foreign exchange originates from the U.S., or where conduct occurs in the U.S. which results in insider trading on a foreign exchange, the necessary jurisdictional requirements are satisfied, and the Commission has the authority to initiate an investigation.

The Commission does not have regulatory authority, however, to oversee foreign markets. This power rests with the local sovereign regulatory authority. Accordingly, the Commission has no means for detecting whether potentially violative transactions have occurred on foreign exchanges. Rather, the Commission has been working with foreign regulators to assist their surveillance of their own markets and the prosecution of insider trading occurring on those markets.

b) Do foreign bank secrecy laws complicate your task to such a degree that they impede the successful prosecution of insider trading cases?

A. Yes. For the past five years the Commission has worked intensively with countries having bank secrecy laws to develop methods for obtaining evidence in insider trading cases. In this regard, a Memorandum of Understanding was reached with Switzerland and a Mutual Assistance Treaty was signed with the Cayman Islands to address these matters. Further, in the Levine case, the Commission was able to develop an agreement which allowed the bank involved to identify its customer notwithstanding Bahamian bank secrecy laws. Development of additional agreements with other countries continues to be a priority.

c) What enforcement mechanisms exist to detect and prosecute insider trading conducted offshore?

A. As discussed in 11(a) above, unless a U.S. broker is involved, off-shore markets are not subject to Commission oversight and thus transactions on those markets are not subject to Commission scrutiny. This does not mean, however, that these markets are not subject to regulation. Indeed, the Commission has recently concluded an agreement with the United Kingdom Department of Trade and Industry, its counterpart in the U.K., which provides for the sharing of surveillance information and for assistance in cases where violations are alleged to occur on the other country's stock exchanges. Through the negotiation of this type of agreement, the Commission is developing a network of securities enforcement authorities who, working together, will be able to protect the integrity of world class securities and the markets on which they are traded.

d) What role can Congress play to increase cooperation between U.S. and foreign authorities in the fight against insider trading?

A. Mutual assistance agreements provide the most effective means for obtaining evidence located outside the U.S. Because the Commission increasingly needs such evidence, the negotiation of cooperative arrangements has become a priority. Foreign governments, such as Switzerland, the United Kingdom and Japan, have already entered into formal cooperative agreements on mutual assistance in surveillance and enforcement matters. However, the agreements -- and the Commission's authority -- are limited in that they make assistance available only where it can be retrieved from an authorities' files or otherwise obtained through voluntary cooperation. In order to compel the production of evidence by issuing investigative subpoenas, the Commission must be conducting an investigation to determine whether there has been a violation of the U.S. securities laws. It may not issue such subpoenas solely for the purpose of assisting a foreign government that is investigating violations of its own laws.

The staff of the Commission is currently drafting for Commission consideration proposed legislation which would authorize the Commission to issue investigative subpoenas for the production of evidence requested by a foreign government investigating possible violations of its own laws, if that foreign government has entered into an agreement whereby it undertook to provide similar assistance to the Commission on a reciprocal basis. The staff believes that authorization to provide such assistance would constitute a greater incentive for foreign governments to enter into mutual assistance agreements.

e) Would the prosecution of these cases be facilitated if the SEC had the power to freeze assets (before they are sent abroad) without first obtaining a court order?

A. The Commission has obtained freeze orders on several occasions to prevent allegedly illicit profits from fleeing the jurisdiction. Such orders have been obtained only where the evidence was strong enough to initiate a civil action alleging insider trading. The ability to freeze assets without first obtaining a court order would undoubtedly assist prosecution of these cases, but it is questionable whether any legislation of this type could satisfy constitutional due process requirements.

Q. 12. Published reports regarding the Boesky case imply that the SEC miscalculated the illegal profits that Boesky earned. These reports state that Boesky illegally earned $203 million, not the $50 million figure claimed by the SEC. To the extent you can discuss the case, could you please explain how the SEC calculated Boesky's profits and arrived at the $50 million figure?

A. The Commission intended the $50 million in disgorgement to reflect the profits which entities which Boesky controlled derived from the transactions alleged in the Commission's complaint to have been made while Boesky possessed inside information obtained from Dennis Levine. One newspaper article reported that Boesky had derived profits of $203 million from such transactions. That calculation was apparently based on Boesky's total profits from his positions in the stocks named in the Commission's complaint. In some instances, however, the Commission alleged that Boesky had acquired material nonpublic information after he had already taken a position in the stock. Because his initial investment was not made while in possession of inside information, the Commission sought disgorgement of only those profits derived from transactions made by Boesky after he received inside information.

Q. 13. Do arbitrageurs play any useful role in the marketplace? If a firm is acting as an investment adviser or banker in a particular takeover attempt, should it be prohibited from engaging in any arbitrage activity in the securities of the companies involved in the takeover?

A. Arbitrageurs provide liquidity in highly volatile market situations and thus gave investors the opportunity to minimize their risks. Thus, I believe that arbitraguers do have a useful role.

Under the procedures in effect at most major firms, the corporate finance or investment banking personnel are forbidden from communicating confidential client information to persons within or without the firm except as necessary to serve a client. Depending on the firm's procedure, the communication of such information may be restricted to senior personnel, such as department heads, or it may have to receive prior approval from the firm's legal department.

A restricted list policy may also be used to prohibit certain research, sales, and trading activities in the securities of companies for which it performs corporate finance services. The scope of the activities restricted with respect to securities on the list may vary depending on the firm's policy and the circumstances of the case, but I am aware of no firm which has a policy which would allow the firm to arbitrage a stock which appears on the restricted list.

In 1980, the Commission adopted rule 14e-3 under the Williams Act to forbid trading in securities sought in a tender offer by persons in possession of material nonpublic information concerning the tender offer. The Commission included rule 14e-3(b) as a safe harbor for institutional traders. This exemption is available if the institution can show:

(1) that the person who made the investment decision for the institution did not know the material nonpublic information; and

(2) that the institution had implemented reasonable policies and procedures to ensure that individuals who make investment decisions for the institution do not trade while actually in possession of material nonpublic information.

The Commission's endeavor in rule 14e-3 to exempt institutions from liability when proper procedures are in place received approval in the House Report accompanying the Insider Trading Sanctions Act of 1984. _See_ H.R. Rep. No. 93-355 at 11 (1984).

ATTACHMENT A

MEMORANDUM OF THE DIVISION OF ENFORCEMENT CONCERNING SURVEILLANCE OF TRADING IN SECURITIES PURCHASED BY DENNIS LEVINE

May 15, 1987

This memorandum describes what action the Commission took with respect to surveillance reports relating to trading in securities that the Commission ultimately alleged were the subject of insider trading by Dennis Levine and others in SEC v. Dennis Levine, et al., 86 Civ. 3726 (R.O.) (S.D.N.Y. 1986).

Background

The Commission alleged that Dennis Levine made $12.6 million between 1980 and 1986 by trading in the securities of at least 54 issuers while in possession of material, nonpublic information about actual or proposed tender offers, mergers, leveraged buyouts and other business combinations. Levine effected these transactions through Bank Leu International, Limited ("BLI"), a Bahamian subsidiary of a Swiss bank. The individual who acted as a broker for Levine's trades through BLI was also named as a defendant in the Levine case.

The repetitive pattern of Levine's trading over a six-year period has raised questions whether the trading had been detected prior to May 1986. The New York Stock Exchange ("NYSE") advised the Subcommittee that it forwarded 21 surveillance reports concerning trading in securities that ultimately were included in the Commission's complaint against Dennis Levine. The National Association of Securities Dealers ("NASD") forwarded surveillance reports concerning trading in three of the securities that ultimately were included in the Commission's complaint.

Although these surveillance reports did focus on trading in securities that were involved in the Levine case, the reports did not focus exclusively upon trading by BLI. At least six of the NYSE reports did not refer at all to trading by BLI, and most of the others merely identified BLI as one among many purchasers prior to the public announcement of the transaction in question.

Commission Investigations

The Commission investigated trading in 13 of the 21 securities that were the subject of NYSE surveillance reports. Thus far, those investigations have resulted in three significant enforcement actions that are unrelated to the Levine case. Five investigations are continuing, and five have been closed without enforcement action by the Commission. The Commission initiated an investigation of trading in one of the three stocks that were the subject of NASD surveillance reports. That investigation was closed without enforcement action.

The majority of the Commission's investigations stemming from NYSE surveillance reports concerned trading by parties other than BLI. However, in several investigations that were closed without enforcement action during 1981 and 1982, the staff did focus on transactions by BLI. In one of those investigations, the staff attempted unsuccessfully to obtain information from BLI regarding the identity of a customer who had made approximately $32,000 by purchasing shares of a target company shortly before the commencement of a tender offer. BLI refused to provide any information that would reveal the identity of the customer. Four other banks located in jurisdictions with bank secrecy laws also refused voluntarily to provide information in that investigation.

Because the U.S. securities laws provide generally that the Commission's investigative subpoena power extends only to the production of documentary and testimonial evidence "from any place in the United States or any state," the Commission could not compel the production of this information by issuing an investigative subpoena to BLI.

The transactions through BLI that were scrutinized were purchases of common stock, as opposed to options, and they were not unusually large for an institutional investor. They were suspect only due to their timing. Without the ability to determine the identity of the person or persons directing the trading through BLI, the staff could not establish that any particular transaction represented trading by a person who possessed material, nonpublic information simply because it originated from a foreign bank.

During the same period as these investigations involving trading by BLI, the Commission was litigating the Santa Fe and St. Joe cases involving insider trading through Swiss banks. 1/ The Commission brought both of those actions without having ascertained the identity of the persons who traded through the Swiss banks. In one of the cases, the Commission obtained a court order compelling a Swiss bank to disclose the identity of its customers notwithstanding Swiss bank secrecy laws. In the other, the Commission successfully obtained the information pursuant to the 1977 Treaty on Mutual Assistance in Criminal Matters between the United States and Switzerland.

The alleged trading profits in the Santa Fe and St. Joe cases were $6.1 million and $1.4 million, respectively, and the circumstances surrounding the trading created a strong inference that the "unknown purchasers" had possessed material,

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1/ SEC v. Certain Unknown Purchasers of the Common Stock of, and Call Options for the Common Stock of, Santa Fe International Corp., 81 Civ. 6553 (S.D.N.Y. 1981); SEC v. Banca Della Svizzera Italiana, 81 Civ. 1836 (S.D.N.Y. 1981). Both cases are described at pages 20 to 22 of your written statement to the Subcommittee for the December 11, 1986, hearings.

nonpublic information. The profits which Levine derived from his insider trading transactions through BLI between 1980 and 1982 ranged from $4,093 to $212,628, and averaged approximately $55,000 per security. The staff's willingness to recommend the filing of lawsuits in Santa Fe and St. Joe without knowing the identity of the ultimate purchasers was based in part on the much larger amount of profits derived through the foreign accounts, as well as other circumstances surrounding the transactions.

The staff's decision not to pursue the BLI trading by resorting to litigation was also influenced by negotiations with Swiss officials that led to the 1982 Memorandum of Understanding (the "MOU") between the United States and Switzerland. These negotiations resulted from the Santa Fe and St. Joe cases. Due to their delicate nature, the staff did not want to use judicial process to compel disclosure by foreign banks while the negotiations were pending. The successful negotiation of the MOU has greatly assisted the Commission's ability to penetrate Swiss bank secrecy laws in insider trading investigations without seeking court orders that are viewed by other countries as an infringement on their sovereignty.

The MOU also established a precedent for obtaining information with the cooperation of foreign government officials. During the investigation preceding the Levine case, the Commission worked with the Bahamas Attorney General to obtain information relating to Levine's trading through BLI. The Commission obtained the requested information after the Bahamas Attorney General provided BLI with written assurances that its release of such information would not violate Bahamian bank secrecy laws.

Commission Enforcement Actions

As noted above, the NYSE surveillance reports led to three significant cases unrelated to the Levine case. One case which originated from a NYSE surveillance report was SEC v. Stephen G. Karanzalis, et al., 84 Cir. 2070 (CLB) (S.D.N.Y. 1984). In that case, the Commission alleged that two document proofreaders and a word processor at a large New York law firm misappropriated material, nonpublic information about pending takeovers from confidential documents, and conveyed that information to others for the purpose of trading securities in exchange for payments of money. All seven defendants in the case consented to permanent injunctions and agreed to disgorge their illegal profits. In addition, six defendants pled guilty to criminal charges.

The Commission's case in SEC v. Manohar Lal Madan, et al., 83 Civ. 5053 (MEL) (S.D.N.Y. 1983), also involved trading in a security that was the subject of a NYSE surveillance report.

In the Madan case, the Commission alleged that Manohar Lal Madan, a word processor at another large New York law firm, improperly disclosed confidential, nonpublic information about pending takeovers to the other defendants named in the case, and that all of the defendants traded while in possession of that information. The Commission obtained permanent injunctions against thirteen defendants, including Madan. Madan and one other defendant also pled guilty to criminal charges, and each was sentenced to six months inprisonment.

The NYSE also identified the trading which led to the filing of SEC v. Melvin N. Pomerantz, 86 Civ. 9499 (PNL) (S.D.N.Y. 1986), in which the Commission alleged that the defendant purchased securities while in possession of material, nonpublic information concerning a proposed leveraged buyout of SFN Companies, Inc. The Commission alleged that Pomerantz misappropropriated the information concerning the buyout offer from an investment banking firm, in breach of a duty of trust or confidence, and that his mother-in-law also purchased SFN stock on his recommendation. Without admitting or denying the allegations in the complaint, Pomerantz consented to a permanent injunction and agreed to disgorge $39,925 in profits that he and his mother-in-law derived from the transactions. Pomerantz also agreed to pay a civil penalty of $79,850 under the Insider Trading Sanctions Act.

Conclusion

The successful prosecution of the Levine case required both the detection of a trading pattern and a method for obtaining the necessary evidence to sustain the charges. The Commission is now in a much better position to detect and prosecute cases of this type than it was five years ago.

Over the past several years, market surveillance has improved in important respects. First, the SROs meet regularly through the Intermarket Surveillance Group to improve coordination of surveillance efforts. Second, market surveillance groups have become increasingly sensitive to repetitive suspicious trading by the same persons or entities. Both the New York and American Stock Exchanges have, in recent years, detected suspicious patterns of transactions which led to successful enforcement actions following referral to the Commission. 2/ With the benefit of surveillance and enforcement experience, both the SROs and the Commission are continuing to improve their ability to detect insider trading.

The Commission's ability to obtain evidence from foreign countries has also improved dramatically over the past several years. By seeking the cooperation of officials in other

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2/ SEC v. Sarzynski, 85 Civ. 3864 (S.D.N.Y. 1985) (NYSE referral); SEC v. Brant, 84 Civ. 3470 (S.D.N.Y. 1984) (AMEX referral).

countries, as it did in the Levine case, the Commission has acquired the necessary information quickly without resorting to confrontational measures.

ATTACHMENT B

WILLIAM PROXMIRE WISCONSIN CHAIRMAN

ALAN CRANSTON CALIFORNIA
DONALD W RIEGLE JR MICHIGAN
PAUL S SARBANES MARYLAND
CHRISTOPHER J DODD CONNECTICUT
ALAN J DIXON ILLINOIS
JIM SASSER TENNESSEE
TERRY SANFORD NORTH CAROLINA
RICHARD C SHELBY ALABAMA
ROBERT GRAHAM FLORIDA

JAKE GARN UTAH
JOHN HEINZ PENNSYLVANIA
WILLIAM L ARMSTRONG COLORADO
ALFONSE M D'AMATO NEW YORK
CHIC HECHT NEVADA
PHIL GRAMM TEXAS
CHRISTOPHER S BOND MISSOURI
JOHN H CHAFEE RHODE ISLAND

KENNETH A McLEAN STAFF DIRECTOR
M DANNY WALL MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, DC 20510-6075

April 27, 1987

Mr. Gary Lynch
Director
Division of Enforcement
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Mr. Lynch:

Thank you for testifying before the Committee on April 22, 1987 on the improper activities in the securities industry.

In order to complete the hearing record, the Committee would appreciate your answers to the enclosed questions from Senator D'Amato, as soon as possible.

Again, I thank you for appearing before the Committee. If you have any questions, please contact Steven B. Harris at 224-5786.

Sincerely,

Bill Proxmire

William Proxmire
Chairman

Enclosure

Questions for Gary Lynch from Senator D'Amato

April 22, 1987

Q. 1. In 1984, the Insider Trading Sanctions Act, which I sponsored, was enacted. The legislation was designed to provide an effective deterrent to insider trading by increasing the penalties from disgorgement alone to disgorgement plus a civil penalty of up to three times the amount of the profits gained or losses avoided. Although the Insider Trading Sanctions Act was intended to be a deterrent, some of the largest and most egregious insider trading cases have been prosecuted since that time.

(a) In light of the recent prosecutions, do you believe that the civil sanctions imposed by the Insider Trading Sanctions Act need to be increased?

(b) Do we really need more severe civil and criminal penalties (5 years and $250,000 fine for each criminal securities law violation) or do we need more cops on the beat to provide a more effective deterrent?

(c) As you know, I have introduced legislation attempting to define insider trading. Pursuant to my attempts, Senator Riegle has asked a panel of securities law experts, including two of this Committee's counsels, to formulate a definition of insider trading. Do you believe that a carefully crafted definition of insider trading could facilitate your enforcement efforts – especially with regard to your ability to bring close cases such as the Foster Winans case? Could you briefly explain your theory of the case and why Winans' alleged violations constitute insider trading?

(d) What specific additional steps would you recommend to crackdown of insider trading?

Q. 2. Some commentators have suggested that illegal trading activity will not be stymied until really harsh criminal penalties are imposed on inside traders. How do you respond to those who claim that the civil and criminal penalties imposed upon Levine, Boesky and Siegel et.al. were too lenient? How do you determine (i.e. what factors) the adequacy of the jail sentences which were imposed in these cases since none of these men ever stood trial? If you find during subsequent investigations that any of the individuals involved in the cases which have settled have failed to tell the whole truth, what recourse do you have against them?

Q. 3. An SEC Office of Chief Economist Study entitled Stock Trading Before the Announcement of Tender Offers: Insider Trading or Market Anticipation concludes that the increase stock prices and trading volumes of target shares before a takeover announcement due to a number of factors that have nothing to do with illegal insider trading. Do you agree with the findings of this report or do you believe that insider trading is the dominant source of information that spurs a runup in a stock's price before the announcement of a takeover bid?

Q. 4. Do you believe that lowering the Schedule 13D reporting acquisition threshold from 5% to 3% or lower could have any impact on the incidence of insider trading?

Q. 5. The first line of defense against insider trading should be the in-house policies and procedures of firms that regularly engage in securities transactions. My perception of these in-house, self-policing mechanisms is that they are illusory and these firms are paying lip service to their commitment to eradicate insider trading. I have introduced legislation that would, under certain circumstances, impose civil penalties upon firms for an employee's violations of the federal securities laws. Do you believe that these firms would have a greater incentive to formulate and implement self-policing mechanisms if the firm was civilly liable for the actions of their employees if they knew or should have known that their employees were trading on inside information? What, if any, provisions of the law permit the SEC to prosecute firms for the actions of their employees? What are the limitations of these laws regarding your ability to prosecute a firm?

Q. 6. Since 1981, what percentage of the insider trading cases which have been successfully brought or settled by the SEC have involved market professionals such as investment bankers, investment professionals and broker dealers and what percentage have been brought against corporate officers and directors and their friends and relatives?

Q. 7. Recently, the New York Stock Exchange, the American Stock Exchange and the NASD have publicized their efforts to increase market surveillance. What role does the SEC play with regard to coordinating the market surveillance activities of the self-regulatory organizations? What percentage of the insider trading cases brought by the SEC since 1981 have been initiated by the SEC's market surveillance efforts? What percentage of these cases have been brought due to the market surveillance activities of the self-regulatory organizations? How effective are the market surveillance activities of the self-regulatory organizations in detecting insider trading or other illegal trading activity - in short, do these expensive and elaborate technological detection systems really work?

Q. 8. Under the current system of detection, is it more difficult to detect the institutional investor who sporadically trades on inside information or the person who trades illegally on a one shot basis? If is is harder to detect the sporadic institutional trader, are special steps being taken to detect his illegal trades?

Q. 9. Were the trades of Dennis Levine and Ivan Boesky ever identified by the SEC's or SRO's surveillance systems? If so, on how many occasions?

Q. 10. We have heard that insider trading cases are very difficult to prove. What are the principal problems confronting your efforts to prosecute inside traders? As enforcers and prosecutors could you recommend any legislation which could facilitate your efforts to enforce the laws currently on the books? Should the SEC be allowed to bring criminal as well as civil actions?

Q. 11. As a result of the increasing internationalization of the securities markets, shouldn't we be focusing on the real threat to our system posed by insider trading which is transactions executed in our securities on overseas markets? Do foreign bank secrecy laws complicate your task to such a degree that they impede the successful prosecution of insider trading cases? What enforcement mechanisms exist to detect and prosecute insider trading conducted offshore? What role can Congress play to increase cooperation between U.S. and foreign authorities in the fight against insider trading? Would the prosecution of these cases be facilitated if the SEC had the power to freeze assets (before they are sent abroad) without first obtaining a court order?

Q. 12. Published reports regarding the Boesky case imply that the SEC miscalculated the illegal profits that Boesky earned. These reports state that Boesky illegally earned $203 million, not the $50 million figure claimed by the SEC. To the extent you can discuss the case, could you please explain how the SEC calculated Boesky's profits and arrived at the $50 million figure?

Q. 13. Do arbitrageurs play any useful role in the marketplace? If a firm is acting as an investment adviser or banker in a particular takeover attempt, should it be prohibited from engaging in any arbitrage activity in the securities of the companies involved in the takeover?

TAKEOVER REFORM - AMENDMENTS TO THE WILLIAMS ACT

QUESTION: 1. (a) In light of the U.S. Supreme Court's decision in CTS v. Dynamics Corporation upholding an Indiana anti-takeover statute, what specific amendments to the Williams Act would you recommend?

ANSWER: On June 23, 1986, the Commission testified on a number of legislative proposals regarding corporate takeovers. Two of these proposals would provide that Congress declares that the internal affairs or governance of a corporation shall be subject to regulation by the laws of the state under which it is organized. These proposals would expressly state that nothing contained in Sections 13 and 14 of the Exchange Act, or any rules thereunder, shall be construed to supersede any state law regulating such internal affairs or governance, or, in the case of one of the proposals, contests for control of the corporation, except when compliance with the state law would preclude compliance with the filing, disclosure, procedural, or antifraud requirements of Sections 13 and 14.

The Commission opposed enactment of these provisions in its testimony on June 23. It noted that the broad authority of the states over matters traditionally viewed as the internal affairs or governance of corporations organized under their laws is well settled. In most respects, the exercise of this authority has served to complement and has operated in harmony with the federal regulation of securities and securities-related transactions.

In CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637 (1987), the Supreme Court addressed the validity of those state statutes relating to the internal affairs or governance of corporations that may affect the operation or success of tender offers that are otherwise governed by the federal regulatory scheme. The Court upheld an Indiana statute providing that shares purchased in a control share acquisition, which in that case was pursuant to a tender offer, are accorded voting rights only to the extent approved by a majority of shares held by disinterested shareholders at a meeting of the shareholders. In reaching this conclusion, the Court found that the statute furthered a basic purpose of the Williams Act and did not conflict with the requirements of the federal tender offer regulatory scheme. The Court also found that any effects that the Indiana statute had on interstate commerce were justified by the state's interests in defining the attributes of shares in corporations organized under its laws and in protecting the shareholders of these corporations.

The Commission did not recommend any proposed legislation with regard to the CTS decision.

QUESTION: 1. (b) What was the SEC's position regarding the Indiana anti-takeover statute? Do you think that the Court's decision challenges the principle that the regulation of takeovers should be the exclusive domain of federal securities laws?

ANSWER: The Commission and the Office of the Solicitor General filed a brief, amici curiae, in the Supreme Court regarding CTS Corp. v. Dynamics Corp. of America. In that brief, the Commission urged that the Indiana Control Share Acquisitions Chapter was invalid under the Commerce Clause. The Commission expressed no view in the brief on the application of the Supremacy Clause.

In analyzing the Commerce Clause question, the Court examined whether the burden on commerce imposed by the Indiana statute was excessive in relation to its local benefits. As noted above, the Court found that any effects of the statute on interstate commerce were justified by the state's interests in defining the attributes of shares in its corporations and in protecting shareholders.

The CTS decision, of course, does give states a role in the regulation of takeovers.

Takeover Reform - Amendments to the Williams Act

QUESTION: 4. Do Chinese Walls really work? Should additional incentives such as civil penalties be imposed on firms to ensure that they really work?

ANSWER: In order to control the flow of inside information, multiservice firms use a Chinese Wall. A Chinese Wall is a set of procedures designed to assure that 1) confidential information is available only to those who need it, and 2) when anyone outside the "need to know" group is given access to such information, that person is blocked from misusing it. Under existing rules, a Chinese Wall is not a requirement, but can be raised by a multiservice firm as a defense to allegations of trading while in possession of material non-public information. A Chinese Wall will not protect against clandestine trading by a thief within the firm who properly receives confidential information, but will reduce the number of people with access to the information and thus reduce the likelihood of a breach of confidentiality. In recognition of the need to strengthen existing Chinese Wall procedures, the Commission will oversee the New York Stock Exchange's development of procedures to examine the operations of Chinese Walls in multiservice firms, focusing on the need to improve the documentation of investment banking transactions, centralization of Chinese Wall controls in the legal or compliance department and the firm's ability to monitor proprietary trading. The New York Stock Exchange has filed a rule, currently out for comment, which would require its member firms to enhance their Chinese Walls, and would subject firms to fines and other penalties for non-compliance. On the need for civil penalties, I refer you to page 6 of Mr. Lynch's response to questions asked on your behalf by Senator Proxmire.

Funding the SEC

Q. 1. One of the greatest problems of the SEC is retaining qualified professional staff due to the gross salary discrepancies between the Commission and private practice.

a) Should the Commission be relieved of the salary contraints traditionally imposed by the civil service laws in order to allow it the flexibility already afforded to the FED?

b) Should the Commission be put on a self-sustaining basis (i.e., the Commission would pay for itself through filing fees, civil damages it has won and other sources of revenue)?

A. The turnover rate for attorneys in 1986 was 23.3%. Although this represents a lower turnover than in prior years, it is still a problem. The Commission attracts very able professional staff who can and do command very high salaries from the private sector. Certainly higher salaries should contribute to greater retention. If the Commission were relieved of the salary contraints traditionally imposed by the civil service laws, another pay structure must be developed. Otherwise, the SEC might exceed its budget and unevenly determine pay levels for employees. Only a substantial pay increase would reduce substantially the attrition rate at the Commission. Accordingly, the Commission would need more than the flexibility already afforded to the Federal Reserve Board. A significant budget increase would be required to provide the flexibility and the funds necessary to retain highly skilled staff.

I do not believe that the Commission should be put on a "self-sustaining" basis, paying for its own programs through filing fees, civil damages recovered and other sources of revenue. None of these revenues necessarily relate to funding requirements or priorities for the Commission's programs. Filing fees are imposed by statute on regulated entities; usually they are a percentage of the value of the transaction at issue. Civil recoveries usually are based upon pecuniary benefits unlawfully obtained by securities law violators. Not only are these sources inaccurate measures of benefits of Commission activity, but they vary from year to year depending on market conditions, and could be inadequate when they are most needed, for example, in a depressed market. I believe it is more a reflection of market conditions than the worthiness of the Commission's programs that fees have recently exceeded our budget. The two are unrelated, and I do not believe that the Commission should be entitled to the excess in times of great activity in the securities market, nor would I hesitate to recommend that this Congress appropriate monies for the Commission far in excess of fees collected if I believed that the public interest and investor protection required it.

Corporate Democracy-One Share/One Vote

Q.1. When will the SEC finally rule on the pending application of the NYSE and Amex regarding changes in their listing standards? Are there obstacles confronting the Commission which are precluding a decision in the near future?

A.1. On June 11, 1987, the Commission instituted proceedings under Section 19(c) of the Securities Exchange Act of 1934 to determine whether to adopt proposed Rule 19c-4. The Rule would require the stock exchanges and NASD to delist the common stock or equity securities of an issuer who issued stock or took other corporate action that would disenfranchise the voting rights of existing shareholders. Public hearings on the proposal were held on July 22, and the public comment period expired August 5. The Commission has deferred action on the NYSE's voting rights rule proposal until resolution of the Section 19(c) proceedings. The Amex withdrew its rule proposal regarding shareholder voting rights on April 24, 1987. The Commission expects to address this issue in the fall.

Program Trading

Q.1. In testimony the Committee received earlier this year from Robert Rittereiser, he stated that the development of derivative products such as options and futures when combined with program trading creates a problem of extraordinary market volatility during those 4 Fridays of the year with "triple witching hours."

a) Is this volatility only limited to 4 triple witching hours each year? (The 114 point swing in the market on January 23, 1987 was not on a triple witching hour Friday; the 120 point drop on September 11 and 12, 1986 was not a triple witching hour Friday.)

b) NYSE Chairman John Phelan recently expressed his concern that a failure to curtail the volatility of a program trade driven stock market could lead to a 1929-style market crash. Do you agree with Phelan's assessment and how could such a crash be triggered by program trading? How likely is the occurrence of such a market calamity?

c) What specific regulation of program trading is required?

Answer:

a) Index arbitrage strategies, generally referred to as "program trading," have been associated with the quarterly concurrent expiration of index options, index futures, options on index futures and options on individual stocks known as "Expiration Friday." No studies have shown that market volatility has increased over the past several years, except for some studies which have shown increases in certain measures of short-term volatility in 1986 and 1987. No studies have shown any link between market volatility or lack of volatility and index-related trading. Nonetheless, the Commission has undertaken several programs and studies in this area in response to public concern.

For the last five "Expiration Fridays," the Commission has requested the New York Stock Exchange to disseminate publicly order imbalances in certain stocks -- those with heavy index-related trading -- one-half hour before the market close. This procedure enhanced the opportunities for market professionals and institutional investors to absorb some of the order imbalances and reduce short-term volatility. On the June 19, 1987 "Expiration Friday," based on an initiative of several options and futures exchanges, expiration of some indexes was based on opening rather than closing prices. The Commission added certain procedures and safeguards for this new experiment, to ensure adequate surveillance and customer protection. The Commission beleives both these experiments have been successful in reducing "Expiration Friday" volatility.

The Commission staff also has studied trading on the particular occasions you have flagged: September 11-12, 1986, and January 23, 1987. The staff reported that the September decline was a result of changed investor perceptions of fundamental economic conditions, not artificial forces of index-related trading, although index-related trading may have shortened the time it took the new investor perceptions to be reflected in stock prices. The staff reported that the January decline could not be traced to index-related or fundamental revaluation, but appears to have been a short-term correction to the uninterrupted rise in market prices in the first three weeks of January 1987.

b) Athough the Commission believes it extremely unlikely that program trading itself could lead to a 1929-style market crash, Mr. Phelan's concern with regard to precipitous market declines was discusssed in detail in the Division of Market Regulation's Report on the Role of Index-Related Trading in the Market Decline on September 11 and 12, 1986. This spectre of a market collapse, or "cascade scenario," triggered by portfolio insurance, though improbable, is conceptually possible.

The scenario begins with index futures prices moving to enough of a discount to trigger short side index arbitrage, index fund substitution, and unwinding of previously established long arbitrage positions. The resulting block sales of stocks depress the equity market to levels that trigger portfolio insurance programs. These programs, which involve the sale of futures contracts, further depress futures prices and cause the cycle to repeat itself. The resultant plunging stock prices could trigger stop-loss sell orders in individual stocks, and force additional liquidations to meet margin calls and broker-dealer capital requirements, finally leading to a market collapse.

The Commission and many market participants believe a number of countervailing market forces limit -- but do not eliminate entirely -- the likelihood of a market collapse. For example, any such decline would likely be halted by buying interest as stocks and futures reached incrementally lower levels. In addition, as futures prices reached lower levels relative to stock prices, portfolio insurance would become increasingly expensive to implement and, therefore, would likely taper off.

c) The Commission continues to monitor closely index-related program trading and its effects on the market. At the present time, the Commission does not believe that additional substantive regulation of program trading is necessary. Nevertheless, because of difficulties encountered by the Commission staff in reconstructing firm proprietary and customer index-related trading in September and January, the Commission's staff currently is working with the NYSE staff to develop routine procedures to capture essential data on index-related transactions. Enhanced reporting and recordkeeping of firm and customer index-related trading should improve the NYSE's and Commission's ability to conduct effective surveillance and facilitate our ability to analyze the role of index-related trading on market volatility. In addition, the Commission will update recent developments regarding Expiration Fridays to determine whether additional adjustments to these precedures are necessary.

S. 1175

Q. 1. Last Friday, I introduced a bill, S. 1175, which amends the Securities Exchange Act of 1934. This amendment to the Exchange Act, which is supported by the SEC, would require banks when performing certain brokerage activities to register with the SEC. This legislation essentially codifies SEC Rule 3b-9 - a rule the SEC promulgated in 1985 and which was invalidated by the District of Columbia Court of Appeals in 1986.

a) Rule 3b-9 was in effect from its promulgation by the SEC until the 1986 court decision. Did any banks register as broker-dealers while the Rule was in effect? Are these banks still registered with the SEC? What has been the SEC's experience with these banks to date?

A. Over 170 bank-affiliated entities registered as broker-dealers during the 10 months that the rule was in effect. The registration of these bank-affiliated broker-dealers was not affected by the District of Columbia Court of Appeals invalidation of the Rule, except to the extent that banks contemplating registering affiliated broker-dealers were no longer required to do so in order to engage in securities activities. A limited number of bank-affiliated broker-dealers may have begun the "deregistration" process. 1/ However, most bank-affiliated broker-dealers have remained registered and apparently are actively engaged in those securities activities approved by their respective banking regulators.

1/ In the event that a bank-affiliated broker-dealer deregistered by filing a Form BDW, the securities activities of the broker-dealer would have to be reintegrated into the bank itself. Only banks are exempted from the definitions of broker and dealer in sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act. Affiliates or subsidiaries of banks are not covered by the exemption and, therefore, must register with the Commission in order to engage in securities activities.

Examinations of bank affiliated broker-dealers, by both the Commission staff and the NASD, have not revealed major operational problems to date. However, the NASD has conducted 204 examinations of 163 bank affiliated members. As a result of the examinations, the NASD has taken at least 10 formal actions, most of which were due to violations of the Commission's net capital rule. In addition, 129 informal actions have been taken as a result of findings of violations of the Commission's books and records provisions, various NASD rules, the margin regulations administered by the Board of Governors of the Federal Reserve Board, and Municipal Securities Rulemaking Board Rules.

b) In your opinion, why did the banks so vehemently oppose the promulgation of Rule 3b-9? What are the additional operating expenses that a bank will incur when it is required to register with the Commission?

A. As the Commission's submission to Congress proposing the introduction of a bill substantially identical to S. 1175 indicated, the Commission does not consider the imposition of a broker-dealer registration requirement to be unduly burdensome for banks, provided that the banks register separate subsidiaries or affiliates to engage in securities activities. However, the banking industry expressed its opposition to Rule 3b-9 in its comment letters and legal memoranda. Banking representatives argued that the Commission lacked legal authority to promulgate Rule 3b-9. They also argued that even if the Commission had legal authority, the rule imposed an unnecessary layer of regulation upon securities activities occurring within banks, and that existing oversight by banking regulators was adequate. The banking industry also argued that Rule 3b-9 would require them to incur both substantial start up and on-going operational costs. During the pendency of the lawsuit brought by the American Bankers Association challenging the legality of Rule 3b-9, the estimated start-up costs presented in affidavits submitted by banks varied from approximately $12,000 to more than $550,000. The Commission's legal memorandum to the district court supporting the rule pointed out that these estimates were inconsistent and not well founded; they contained estimates for non-existent SEC filing fees and exaggerated costs for preparing employees for NASD examinations. In addition, the Commission's memorandum pointed out that operational cost estimates for computers, office equipment and furniture, as well as other costs, had already been incurred by banks engaged in brokerage activity internally. Accordingly, the Commission believes that the start-up and operational costs directly attributable to SEC registration are minimal.

c) How will the enactment of S. 1175 improve the safety and soundness of the banking system and ensure more investor protection?

A. By requiring banks to place their securities activities in a separate affiliate or subsidiary registered with the Commission, the enactment of S. 1175 would ensure that all securities market participants would be subject to the regulatory system designed to protect investors.

The Commission and the self regulatory organizations administer a system of rules and regulations such as extensive net capital, books and records and customer protection rules, systematically designed to protect investors. The coordinated system administered by the Commission is designed to assure that investors are adequately protected through full disclosure and the prevention of unfair and inequitable practices in the securities markets. Broker-dealer registration is an important element of this regulatory system. As banks expand both the volume and range of their securities activities, the absence of a requirement that their securities activities be carried out in a registered broker-dealer substantially undermines the Commission's regulatory system and creates regulatory disparities.

The potential effects of securities activities on the safety and soundness of the nation's banking system were recently considered by the United States General Accounting Office ("GAO") in the Report to the Chairman of the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Banking, Finance and Urban Affairs, Bank Powers: Insulating Banks from the Potential Risks of Expanded Activities ("GAO Report"). The GAO Report addressed expanded bank powers generally. It noted that many regulators and commentators advocate placing certain new banking activities in separate affiliates in order to maximize the ability of banks to "protect themselves from the risks of expanded activities. . . [because] [i]n a parent-subsidiary relationship, the parent has no legal obligation to come to the rescue of the subsidiary, and the parent's risk is normally limited to the amount it invested in the subsidiary." 2/ The GAO noted, however, that even if a bank and its affiliates are separate, bank deposits may not be fully insulated from the affiliates' activities. Banking regulators, however, generally appear to favor insulation of bank securities activities in separate affiliates, in order to maximize the protection of a bank's banking operations. This approach has been adopted in numerous approvals of applications to the federal banking regulators seeking authority to engage in expanded bank securities activity. 3/

2/ *GAO Report* at 19.

3/ *See e.g.*, Approval by the Board of Governors of the Federal Reserve System for Bank of America to acquire Charles Schwab & Co., 69 Fed. Res. Bull. 105; 12 C.F.R. 225.225(b)(15). *See also* Decision of the Office of the Comptroller of the Currency regarding Security Pacific Bank's establishment of a subsidiary to engage in brokerage activities [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶99,284 (Aug. 26, 1982); Decision of the Board of Governors of the Federal Reserve System Approving National Westminister Bank's Application to Provide Brokerage Services and Investment Advisory Services [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶86,610 (October 23, 1985); letter from Judith A. Walter, Senior Deputy Comptroller for National Operations, Office of the Comptroller of the Currency, to R.C. Gallagher, President, Kellogg-Citizens National Bank (April 16, 1986); letter from Michael Bradfield, General Counsel, Board of Governors of the Federal Reserve System, to Margery Waxman, Esq., Sidley & Austin (June 5, 1986);

(footnote continued)

The enactment of S. 1175 may not guarantee absolute protection of the nation's banks from downturns in the securities markets but would at least ensure that the insulation that is provided by the parent-affiliate relationship was in existence for every bank engaged in certain securities activities.

3/ Footnote Continued

Order Approving Application to Underwrite and Deal in Commercial Paper to a Limited Extent [Current Matters] Fed. Banking L. Rep. (CCH) ¶86,912 (March 18, 1987), in which the Board authorized The Chase Manhattan Corporation to establish an affiliate to underwrite and deal, as principal, in third party commercial paper to a limited extent; Order Approving Applications to Engage in Limited Underwriting and Dealing in Certain Securities [Current Matters] Fed. Banking L. Rep. (CCH) ¶86,957 (April 30, 1987). The Court of Appeals for the District of Columbia Circuit has also recently upheld a regulation adopted by the Federal Deposit Insurance Corporation in 1984 that permits insured banks that are not members of the Federal Reserve System to establish or acquire affiliates to engage in, among other things, securities underwriting and dealing activity. See Investment Company Institute and Securities Industry Association v. FDIC, 815 F.2d 1540 (D.C. Cir. 1987), approving promulgation of 12 CFR 337.4, Securities Activities of Subsidiaries of Insured Nonmember Banks: Bank Transactions with Affiliated Securities Companies, 49 F.R. 46709 (November 28, 1984).

ATTACHMENT C

QUESTION 1. Financial Reporting Release No. 28 (FRR-28): As part of the FSLIC recapitalization legislation, Congress has ordered the Bank Board to require for regulatory purposes asset writedowns no more stringent than under GAAP. How does the Commission's Accounting Release FRR-28 apply to credit losses on loans secured by real estate? How active does the real estate market have to be for reliance to be placed on potentially "fire sale prices" rather than derived values?

ANSWER: As to asset writedowns, the accounting provisions of FRR-28 apply to collateralized loans (including loans secured by real estate), only if the collateral is repossessed, or is considered to be substantively repossessed, */ by the creditor. FRR-28 points out that in such circumstances, Statement of Financial Accounting Standards No. 15 ("FAS 15", the basic accounting standard applicable to repossessions of collateral in satisfaction of loans) requires the creditor to recognize a loss equal to any excess of the creditor's recorded investment in the loan over the fair value of the collateral. For this purpose, market value is presumed to be the best indicator of fair value, assuming that an active market exists.

Neither FRR-28 nor FAS 15 specify criteria for determinations of what should be considered an "active market" for a particular asset. It would be impractical to do so in an accounting pronouncement of general applicability, given the varied market conditions and mechanisms for each type of asset that

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*/ FRR-28 states that loan collateral generally should be considered to be substantively repossessed by the creditor when:

1. The debtor has little or no equity in the collateral, considering the current fair value of the collateral; and
2. Proceeds for repayment of the loan can be expected to come only from the operation or sale of the collateral; and
3. The debtor has either:
    - (a) formally or effectively abandoned control of the collateral to the creditor, or
    - (b) retained control of the collateral but, because of the current financial condition of the debtor, or the economic prospects for the debtor and/or the collateral in the foreseeable future, it is doubtful that the debtor will be able to rebuild equity in the collateral or otherwise repay the loan in the foreseeable future.

might collateralize loans (e.g., real estate, precious metals, investment securities, equipment, etc.). In general terms, however, an active market is presumed in circumstances where transactions in the particular item (or similar items) have been occurring and the owners of such items are not precluded from selling due to an absence of buyers. With respect to particular real estate, for example, fair value should be determined by reference to recent sales prices of similar real estate in the geographic area of the subject property, to the extent that such data are available.

QUESTION 2. Accounting and Disclosure for Financial Instruments: Does the Commission intend to await guidance from the Financial Accounting Standards Board in terms of appropriate reflection of financial instrument positions in an entity's financial statements? Will the Commission move quickly on any further interim disclosure requirements? Does the Commission propose to take a more active role in determining investment vs. trading portfolios and historical cost vs. mark-to-market carrying values?

ANSWER: The Commission generally looks to independent private sector standard-setting bodies, such as the FASB, for development of accounting and financial statement disclosure guidance, subject to Commission oversight. The FASB, at the urging of the Commission and with assistance from the staff of the Commission and industry representatives, currently is working to develop comprehensive accounting and disclosure guidance for financial instruments (including matters such as investment vs. trading portfolios and historical cost vs. mark-to-market carrying values). The first stage of this project is expected to result in standards for improved disclosures about the credit risk, market values, maturities and interest rate sensitivity of financial instruments. These disclosure standards are expected to be proposed for public comment within the next several months.

The Commission does, however, promulgate accounting and disclosure guidance in circumstances where timely guidance appears necessary for investor protection and the private sector bodies are unable to do so timely. For example, during the time since the FASB began the initial research work on its financial instruments project, the following Financial Reporting Releases (FRRs) and Staff Accounting Bulletins (SABs) dealing with accounting for and disclosure of various types of financial instruments have been published.

Release No.	Subject Matter
FRR No. 24	Disclosures regarding repurchase and reverse repurchase agreements.

FRR No. 27	Disclosures by bank holding companies regarding loans to certain economically-troubled countries.
FRR No. 28	Accounting for loan losses.
SAB No. 59	Accounting for noncurrent marketable equity securities.
SAB No. 60	Accounting for and disclosure of financial guarantees.
SAB No. 61	Purchase accounting adjustments to allowances for loan losses.
SAB No. 64	Accounting for redeemable preferred stock.
SAB No. 66	Disclosure of deposit/relending arrangements between banks and foreign borrowers.
SAB No. 68	Accounting for increasing rate preferred stock.
SAB No. 69	Disclosures by thrift holding companies.
SAB No. 70	Accounting for nonrecourse debt collateralized by lease receivables.

Furthermore, subject to Commission oversight, the FASB's Emerging Issues Task Force (EITF) has been very successful since its formation in mid-1984 in providing timely accounting and disclosure guidance regarding more than sixty separate issues relating to financial instruments and financial institutions. Many of those issues were brought to the EITF at the urging of the Commission's staff. In summary, the Commission staff has taken an active role with respect to accounting for and disclosure of financial instruments, and will continue to do so.

Q.3. Does the Commission have any concerns about investor disclosures for exotic new mortgage-backed securities? Does the Commission feel that further disclosures should be made especially for instruments targeted towards individuals' investments? Does the Commission propose to make any changes in its Capital Rule 415 shelf registration requirements for mortgage-backed securities especially REMICs?

A.3. The Commission believes that the information currently provided to purchasers of mortgaged-backed securities, whether they are institutions or individuals, is sufficient for making informed investment decisions. New developments in this area, however, are being monitored to determine the need for additional disclosure. Any additional requirements will, of course, be carefully considered and designed so as not to unduly interfere with the capital formation process, while providing necessary investor protections.

The Commission has no immediate plans for revising Rule 415 with respect to mortgage-backed securities. Currently, mortgage-backed securities that meet the definition of a "mortgage-related security" under the Secondary Mortgage Market Enhancement Act of 1984 may be offered pursuant to the provisions of Rule 415. This definition does not differentiate between securities which elect or do not elect REMIC status under the tax laws. Eligibility is based on other criteria including whether the security is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization.

MUTUAL FUND ADVERTISING

Question 4. Does the Commission plan to adopt last December's proposal on mutual fund rate of return disclosures?

Does the Commission propose to require the amortization of premiums on debt securities into the disclosed rate of return symmetrically along with discounts?

Does the Commission propose to adopt the market value amortization method discussed in last year's proposal?

Answer: The Commission's Division of Investment Management will recommend, this fall, draft rules for Commission adoption. The Commission received 46 comment letters on the mutual fund advertising rulemaking proposal, many of which raise difficult and complex questions.

The Commission proposal called for the amortization of both discounts and premiums into income for the purpose of calculating the yield of a mutual fund. None of the commenters opposed this requirement, although they were divided as to whether amortization should be based on the cost of the portfolio securities or on their current market value. Either method follows accepted accounting principles.

The Commission proposal would base amortization on the cost of the portfolio securities. The proposal followed a method suggested by the Investment Company Institute ("ICI") (the mutual fund trade association) in a submission to the staff proposing a yield formula. In the release accompanying the proposal, the Commission explained that while use of the market amortization method might produce a more accurate yield, its use might greatly complicate the calculation and be very burdensome on funds. The majority of the commenters, including the ICI, nonetheless agreed that amortization from current market value is preferable and suggested a method of market amortization that, according to its proponents, would not be too burdensome. The Commission staff is studying this question.

Q.5. I have been following an issue with special interest and concern for some two years that in my judgment has not yet been satisfactorily resolved. That issue is the process by which banks, security firms and savings institutions guarantee signatures on stock certificates and related documents. Banks and brokers routinely provide this service to their customers, but savings institutions, for reasons that escape me, are frequently not allowed by stock transfer agents to provide this necessary service to their customers. I know that this matter was brought to the attention of Commission staff several years ago, but to date the problem still has not been satisfactorily resolved. Would you please explain why a matter of this nature can't be more promptly resolved so that savings institutions and others will not continue to be at a competitive disadvantage with regard to this service?

A.5. The Commission has devoted substantial staff resources during the last three years to develop industry mechanisms capable of accommodating over 30,000 authorized guarantors and to encourage transfer agents to accept signature guarantees from all financially responsible, authorized guarantors -- banks, brokers, savings associations and credit unions. Because a transfer agent's decision whether or not to accept a financial institution's signature guarantee involves a credit determination that would expose the transfer agent to considerable future liability, the Commission staff has encouraged a private sector resolution to the signature guarantee problem.

An industry task force is working to develop new signature guarantee procedures that, coupled with a surety bond, would permit all financially responsible institutions to guarantee signatures on stock transfers and protect transfer agents and other financial guarantors against losses associated with forged or unauthorized endorsements. That task force includes representatives of brokers, banks, savings associations, credit unions, exchanges and clearing agencies. This is the first time representatives of those industries have worked together to solve a particular problem. The task force has agreed to form an insurance company under the Liability Risk Retention Act of 1986 to underwrite the surety bond and to provide automated signature guarantees (in place of thousands of specimen signatures that must be filed and reviewed daily). The task force has agreed on a tentative premium schedule, which will accommodate the needs of small and large financial institutions. The task force is in the final stages of forming the insurance company -- selection of the sponsor. The task force is also waiting for final endorsements from its constituents, including savings associations. The Commission staff has every expectation that program implementation will not be delayed beyond year-end 1987.

MEMORANDUM

May 15, 1987

TO: Chairman Shad

FROM: Annette Poulsen
Office of the Chief Economist

SUBJECT: Estimate of the Portion of Stock Market Profits Arising from Corporate Takeovers Over the Past Three Years that Has Accrued to Risk Arbitrageurs

This memorandum is in response to the request you received from Senator William Proxmire, Chairman of the Senate Committee on Banking, Housing and Urban Affairs, in his letter of February 17, 1987. Item 4 of Senator Proxmire's letter requests an estimate of the portion of stock market profits arising from corporate takeovers over the last three years that has accrued to risk arbitrageurs.

Based on available data, it appears that over the three-year period 1984-1986 risk arbitrageurs have captured less than three percent, and perhaps as little as one percent, of the total profits earned by stockholders in acquisitions of public companies, restructurings, and other similar transactions.

The calculation of this percentage is difficult and requires that we make two separate estimates. First, we must estimate the profits earned by risk arbitrageurs in takeover and takeover-related transactions. Second, we must estimate the total profits earned by stockholders in takeovers and takeover-related transactions. The percentage requested in Senator Proxmire's letter is a ratio of these two estimates, and is therefore sensitive to the variance in both.

Estimate of Arbitrage Profits

Data gathered by the New York Stock Exchange at the request of the Division of Market Regulation ("Division")[1] suggest that aggregate arbitrage profits at 31 major firms for calendar years 1984, 1985, and 1986 are as follows:

Year	Profit
1984	$180.2 million
1985	$386.8 million
1986	$566.6 million
Total	$1,133.6 million

Upon reviewing the NYSE's figures, we note that the collective net profit attributable to risk arbitrage of the five firms with the largest risk arbitrage profits in 1986 accounted for approximately 55.37%, 53.04% and 65.07% of the collective risk arbitrage profit of all 31 member firms for the years 1984-86, respectively. We also note that all or nearly all of the profits (at least 97%) from these five firms were derived from risk arbitrage. To highlight this fact, the chart in Exhibit A shows, among other things, the percentage of profits attributable to the risk arbitrage activities of the other 26 firms. Accordingly, the survey suggests that risk arbitrage profits are not uniformly distributed in the sample, and that a small number of firms specializing in risk arbitrage activities account for a disproportionate share of aggregate arbitrage profits.

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[1] A summary of arbitrage profits prepared by the New York Stock Exchange ("NYSE") on the basis of the survey described below is attached as Exhibit A.

All of these figures are, at best, crude estimates. The firms' responses to the NYSE's survey were not independently verified, their calculations were not always consistent, and not all firms provided complete information. Moreover, because the sample of respondent firms may not have encompassed all firms active in the risk arbitrage market over the relevant time period (for example, the Boesky firms are not respondents), the survey may underestimate the aggregate profits of the industry. As explained below, we attempt to adjust for potential downward bias by grossing up the estimates of arbitrage profits.

Estimates of Stock Market Profits

The Office of the Chief Economist ("OCE") obtained three estimates of total stock market profits arising from corporate takeovers in recent years. Each estimate relies on a different sample and uses a different methodology. Accordingly, the estimates are not directly comparable.

Estimate by Office of the Chief Economist. The OCE has estimated premiums received by shareholders in successful tender offers from 1981 through 1986. Premiums are measured from 20 trading days before to 20 trading days after the tender offer. These premiums are adjusted by overall changes in the market to isolate better the premium directly attributable to the offer. OCE reports that these premiums exceed $54 billion, with almost $38 billion of that total received in the last three years. (See Table 1)

This estimate, however, significantly understates the profits earned by stockholders in all takeover-related transactions because:

(1) The OCE sample excludes all transactions that do not involve tender offers. Major mergers, leveraged buyouts, and recapitalizations in which stockholders earned substantial profits are therefore excluded.

(2) The OCE sample is limited to the first successful tender offer in which some shares were purchased under the terms of the offer. Thus, if an auction for the firm develops, or if the initial bidder increases his bid, OCE's estimate does not capture the full premium.

(3) The methodology excludes the value of any run-up in value that may have occurred more than twenty days prior to announcement of the first successful tender offer.[2]

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[2] *See* OCE, *Stock Trading Before the Announcement of Tender Offers: Insider Trading on Market Anticipation?* (Feb. 24, 1987). Although the OCE study examines run-ups only during the twenty-day period preceding the public announcement, data suggest that, in some cases, run-ups may have begun even earlier, and the use of a twenty-day window may therefore understate the actual size of the premium for some transactions.

TABLE 1

Dollar Value of Net-of-Market Premiums Paid to Shareholders of Targets of Tender Offers from 1981-1986, for NYSE- and ASE-Listed Firms and for All Publicly-Traded Firms[3].

(Dollar Values in Billions)

Year	No. of NYSE & ASE Firms	Net-of-Market Premium[4]	Value of Net-of-Market Premiums Paid, NYSE & ASE Firms[5]	No. of All Public Firms	Estimated Value of Net-of-Market Premiums Paid, All Public Firms[6]
1981	27	41.4%	$5.702	60	$7.405
1982	34	32.3%	$3.222	52	$4.150
1983	20	26.4%	$4.265	34	$4.987
1984	46	27.8%	$7.972	82	$9.830
1985	45	25.1%	$10.054	107	$13.254
1986	--	-----	------	152	$14.911
1981-1985	172	30.0%	$31.217	487	$54.537

[3] Only first offers of ultimately successful bids are included here. An offer is considered successful if some shares were purchased under the terms of the offer.

[4] Percent premiums are measured from 20 trading days before the offer to 20 trading days after and are "net-of-market", i.e., we subtract out overall percent changes in the level of a market index from percent changes in share prices.

[5] Dollar values of premiums are found by first computing the market value of equity for each firm -- multiplying the number of shares outstanding by the share price 20 trading days before the offer. Then, this value is multiplied by the percent premium paid in the offer for that firm.

[6] While we have sufficient data to accurately measure NYSE and ASE premiums from 1981-1985, premiums for firms traded over the counter and for targets in 1986 are estimated. Our estimates are based on an average market value of equity of $172 million per OTC-traded firm and average percent premium of 30%. In 1986, we assume that the average market value of equity of all firms is $327 million.

Accordingly, the OCE estimate must be adjusted upward to arrive at an estimate of stockholder profits in all takeover-related transactions.

W.T. Grimm & Co. Estimates. W.T. Grimm & Co. collects data describing merger and acquisition activity throughout the economy.[7] Among the data gathered by W.T. Grimm are estimates of the total dollar value paid for publicly traded securities involved in takeovers and other substantial share-acquisition programs,[8] as well as the average premium paid for those shares. The premium is measured relative to the market price prevailing five days prior to announcement of the transaction.[9] These data series can be combined to derive the following estimates of the total dollar value of the premiums paid to stockholders in these transactions:

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[7] See W.T. Grimm & Co., Mergerstat Review (1985). This volume reports "publicly announced formal transfers of ownership of at least 10% of a company's assets or equity where the purchase price is at least $500,000 and where one of the parties is a U.S. company." Id. at 1, fn. *. Transactions are recorded as of the date announced, and not as of the date completed. Cancelled transactions are deducted from totals in the year in which the cancellation occurs.

[8] Id. at 11.

[9] Id. at 121.

Table 2

Estimate of Stockholder Profits in Takeover Transactions Based on W.T. Grimm Data

1981-1985

Year	Total Dollar Value Paid for Shares of Publicly Traded Sellers (\$ Millions)[10]	Average Percent Premium Paid Over Market Price[11]	Estimated Dollar Value Premium Paid for Shares of Publicly Traded Sellers (\$ Millions)[12]
1981	56,569	48.0%	18,347
1982	31,502	47.4%	10,130
1983	39,471	37.7%	10,807
1984	82,731	37.9%	22,738
1985	116,676	37.1%	31,573
1986	89,866	38.2%	24,840
Total	416,814	-	118,435

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[10] *Id.* at 11.

[11] *Id.* at 121.

[12] The dollar value of the premium is calculated by subtracting the pre-takeover announcement market value of the target company from the total dollar paid for the targets. The pre-takeover value equals the total value paid divided by one plus the percentage premium paid.

The W.T. Grimm estimate of $118.4 billion in stockholder profits is larger than the OCE estimate because it includes merger, leveraged buyout, and recapitalization transactions excluded from the OCE sample. The Grimm estimate is still, however, likely to understate the total profits earned by stockholders because:

(1) the percentage premium calculated by Grimm is based on the market price only five days before the initial public announcement and thus does not capture the premium attributable to increases in share prices that occur more than five days in advance of a public announcement;[13]

(2) the five-day window is too short to capture the effect of many bid increases that occur in contested takeovers or negotiated transactions;[14] and

(3) the Grimm data do not include corporate divestitures which often substantially boost stock price but for which a percentage premium cannot be calculated.[15]

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[13] See OCE study, supra note 2, which indicates that a significant percentage of the total price gain from tender offers occurs more than five days prior to the announcement date.

[14] See Jarrell, The Wealth Effects of Litigation by Targets -- Do Interests Diverge in a Merge? 28 J. L. & Econ. 151 (1985); Bradley, Desai and Kim, Specialized Resources and Competition in the Market for Corporate Control (Sept. 1982) (unpublished manuscript).

[15] Divestitures totalled $192,052 million over the 1981-86 period, including $59,927 million in 1986. A significant percentage of these divestitures involves sales of divisions or subsidiaries of publicly traded companies.

The Grimm estimate is also not directly comparable with the OCE estimate because the Grimm data do not adjust for shifts in general market price levels over the five-day window.

In sum, an estimate derived from the Grimm data is likely to understate stockholder profits, though not as substantially as the OCE data.

Jensen Estimate. In testimony before the House Subcommittee on Telecommunications and Finance, Professor Michael C. Jensen of the Harvard Business School and the University of Rochester estimated that shareholders have benefitted from takeovers "by amounts that exceed $100 billion in the last six years."[16] Professor Jensen provided no basis for his estimate in his written testimony. In telephone communications, Professor Jensen explained that his estimate was based on an extrapolation from prior OCE publications and a review of the W.T. Grimm data.

Reconciling the Estimates. The OCE has reviewed the W.T. Grimm estimates and believes that they provide a reasonable lower bound on total stockholder profits from all takeover-related transactions. Thus, the W.T. Grimm data are used as an estimate of the minimum profits earned by stockholders in takeover-related transactions.

Significant stock price increases can occasionally result from a divestiture by a publicly traded company

[16] Testimony of Michael C. Jensen before the House Subcommittee on Telecommunications and Finance Committee on Energy and Commerce, April 1, 1987.

Arbitrage Profits as a Percentage of Shareholder Profits

Table 3 reports a series of estimates of arbitrage profits expressed as a percentage of stockholder profits. For each year we calculate four percentages, based on four different assumptions about the accuracy of the NYSE's arbitrage profit survey and the accuracy of the W.T. Grimm data. The assumptions are designed to indicate the sensitivity of the estimates to errors in the underlying data.

The assumptions are:

(1) the arbitrage profits are accurately stated and the W.T. Grimm data are accurate;

(2) the arbitrage profits are accurately stated and the W.T. Grimm data understate stockholder profits by 25%;

(3) the arbitrage profits reported in the survey are only half of the relevant measure of arbitrage profits and the W.T. Grimm data are accurate; and

(4) the arbitrage profits reported in the survey are only half of the relevant measure of arbitrage profits and the W.T. Grimm data understate stockholder profits by 25%.

As described in Table 3, the percentage of stockholder profits that has accrued to arbitrageurs over the three year period 1984-1986 ranges from 1.13% to 2.82%, depending on the underlying assumptions. On an annual basis, the data appear to suggest an increasing trend in the percentage of profits accruing to risk arbitrageurs, although the 1986 estimates still range only from about 2% to 5%. This trend is consistent with press reports suggesting a substantial increase in the amount of capital that has been available for risk arbitrage transactions.[17] The trend does not necessarily suggest that risk arbitrage has become more profitable on a capital-adjusted basis. Nor does this trend necessarily suggest that the benefits of legitimate risk arbitrage for all market participants (i.e., the reallocation of risk associated with the completion, timing, and pricing of takeover-related transactions) have diminished or become more expensive over the last three years. Analysis of those characteristics of the risk arbitrage market would require data about capital and margins that are currently unavailable.

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[17] See e.g., Anders, Top Arbitragers Are Increasing Capital, Raising Some Concern as Well as Money, Wall St. J., Apr. 3, 1986, at 10, col. 1. In the wake of Commission and Justice Department actions against insider trading, the amount of capital available for risk arbitrage transactions may have decreased. See Garcia and Anders, In Arbitrage, Risks Are Burgeoning Along With Profits, Wall St. J., Dec. 23, 1986, at 6, col. 1.

Table 3

Arbitrage Profits as a Percentage of Total Shareholder Profits

1984-1986

			Assuming that Arbitrage Profits Are Accurately Reported and		Assuming that Reported Arbitrage Profits Are Half of Actual Profits	
			(1)	(2)	(3)	(4)
Year	Arbitrage Profits ($ Billions)[18]	Stockholder Profits ($ Billions)[19]	W.T. Grimm Data Are Accurate	W.T. Grimm Data Are Understated By 25%	W.T. Grimm Data Are Accurate	W.T. Grimm Data Are Understated By 25%
1984	0.180	22.738	0.79%	0.63%	1.58%	1.27%
1985	0.387	31.573	1.23%	0.98%	2.46%	1.96%
1986	0.567	24.840	2.28%	1.82%	4.56%	3.64%
84-86	1.134	79.151	1.43%	1.15%	2.87%	2.29%

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The Honorable Donald W. Riegle, Jr.
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Dear Sirs:

We are taking this opportunity to comment on the wide-ranging bill (S. 1323) which you have introduced entitled the Tender Offer Disclosure and Fairness Act of 1987.

Our comments are not intended to be all-encompassing. Rather they relate to the effect of the bill on certain problem areas which we believe should be addressed, including the roles to be played by the federal and state governments in regulating corporate affairs; proposed changes to the tender offer process; and the Section 13(d) reporting requirements.

Our review of the bill is from the perspective of lawyers who are familiar with mergers, acquisitions and other transactions in the takeover process.

This letter, which was initially prepared by the Tender Offer Coordinating Committee and the Subcommittee on Proxy Solicitations and Tender Offers of the Federal Regulation of Securities Committee of the Section of Corporation, Banking and Business Law (the "Section") of the American Bar Association (the "ABA"), has been approved for submission to you on behalf of the Section. However, the opinions expressed below do not necessarily reflect the views of individual members of the ABA. Further, the views set forth below are being presented only on behalf of the Section and, while they are thought to be consistent with policies of the ABA, they have not been approved by the House of Delegates or the Board of Governors of the ABA and should not be construed as representing the position of the ABA.

A. The Roles of the Federal and State Governments in Regulating Corporate Affairs.

1. The Context of the Question. The regulation of takeovers involves areas traditionally governed by the federal government under the securities laws, and also areas traditionally regulated by state corporate and common law. Takeovers typically involve transactions in securities, which are subject to a panoply of disclosure, antifraud and proxy

rules intended to protect the federal interest in a national capital market. But the securities are issued by corporations which are themselves creatures of state law. To the extent Congress seeks to regulate the governance of target companies -- when shareholder votes are required, what votin provisions can be included in a charter, when a company can buy in its own shares -- Congress intrudes in an area which traditionally has been the subject of state regulation, both through state corporation statutes and through case-by-case adjudication of the rights and responsibilities of corporate directors. It is recognized that while corporate governance has been an area traditionally reserved for state law, it ca be argued that Congress has an interest in preempting second generation state statutes aimed at regulating takeovers if i can be demonstrated that the state statute disrupts the national securities markets.

The ABA has in the past carefully considered the question of state control of the internal governance of corporations. The following resolution was adopted by the ABA House of Delegates on the recommendation of the Section:

> "RESOLVED, that the American Bar Association (1) believes that the internal governance of corporations is best left to state law and urges Congress not to enact, absent compelling reasons, legislation directed at problems associated with tender offers for corporate control where such legislation would intrude into traditional state law or limit the ability of courts to evolve solutions to such problems; and (2) opposes legislatio that would reverse or restrict the courts in applying the long-standing principle which has afforded

> a presumption of validity to business decisions made by boards of directors in the good faith exercise of their business judgment."

The report accompanying this resolution takes a strong and unequivocal position against any legislation which would reverse the business judgment rule and emphasizes that only upon a showing of compelling reason should Congress enact any legislation that would "federalize" any other significant part of traditional state corporation law. Thus, tender offer activity should not be used to establish or spread a federal law of corporations.

The Supreme Court has recently reiterated the central role of state regulation of corporate affairs in CTS Corp. v. Dynamics Corp. of America, Fed. Sec. L. Rep. ¶93,213 (April 21, 1987), upholding the constitutionality of Indiana's control share acquisition act. The Court, speaking of our vital markets in securities, stated:

> "This beneficial free market system depends at its core upon the fact that a corporation -- except in the rarest situations -- is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate laws of the State of its incorporation.
>
> * * *
>
> It is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares."

RISK ARBITRAGE NET PROFITS

FIRM	AMOUNT (in thousands) 1986	1985	1984	% OF TOTAL NET PROFITS 1986	1985	1984
1	$ (2,300)	$ 5,400	$ 1,100	-	60.0	-
2	63,257 (A)	27,082 (A)	21,177 (A)	99.2	97.0	98.4
3	4,112 (A,E)	12,223 (A,E))	8,398 (A,E)	2.8	18.2	27.1
4	N/P	N/P	N/P	-	-	-
5	23,147.	7,036	15,950 (A)	17.6	8.0	9.7
6	38,517 (A)	21,924 (A)	12,924 (A)	100.0	100.0	100.0
7	51,654 (A,H)	64,962 (A,H)	20,591 (A,H)	100.0 (H)	100.0 (H)	100.0 (H)
8	5,400	23,800	7,208	1.3	6.5	3.5
9	30,800	41,700	19,500	3.9	8.5	3.5
10	14,700 (A)	28,900 (A)	N/A	70.0	99.0	N/A
11	N/A	N/A	N/A	N/A	N/A	N/A
12	4,151	4,002	2,376	1.0	1.4	2.3
13	27,692 (A)	4,223 (A)	4,190 (A)	57.3	59.5	14.7
14	400 (A,C)	4,700 (A,C)	N/A	100.0	100.0	N/A
15	3,200 (A)	1,300 (A)	840 (A)	41.0	35.0	33.0
16	N/A	N/A	N/A	5.0	5.0	5.0
17	1,085 (A)	470 (A)	261 (A)	1.6	1.6	1.1
18	N/P	N/P	N/P	15.3	12.4	7.8
19	(37,774)(A)	3,221 (A)	4,178 (A)	-	.9	5.9
20	13,220 (A)	N/A	N/A	77.9	N/A	N/A
21	0	3,201 (A)	4,512 (A)	0	15.5	N/S
22	2,103	2,162	450	N/S	N/S	N/S
23	N/A	N/A	N/A	5-10	5-10	5-10
24	4,400 (B)	2,300 (B)	1,500 (B)	2-3	2-3	2-3
25	20,877 (A)	8,431 (A)	4,722 (A)	14.0	15.0	50.0
26	9,700	9,900	4,000	3.1	4.8	3.8
27	107,200 (A)	45,100 (A)	25,700 (A)	100.0	100.0	100.0
28	108,075 (A,G)	46,097 (A,G)	19,351 (A,G)	100.0	100.0	100.0
29	(245)	1,006	(244)	(8.0)	63.9	20.1
30	22,600	12,800	7,300	7.0	7.0	7.0
31	12,422 (A)	7,064 (A)	1,641	15.6	26.1	N/A

#0331L

KEY

N/P - NOT PROVIDED
N/A - NOT APPLICABLE
N/S - NOT SIGNIFICANT

(A)	PRE-TAX
(B)	ESTIMATED
(C)	TOTALS FOR ENTIRE FIRM INCLUDING ALL PROPRIETARY TRADING
(D)	DOES NOT INCLUDE PARTNERSHIP PROFIT DISTRIBUTION
(E)	NET OF COST OF CARRY INTEREST
(F)	INCLUDES PARTNERSHIP PROFIT DISTRIBUTIONS
(G)	PRIMARILY ARBITRAGE
(H)	REPRESENTS ENTIRE FIRM-RISK ARBITRAGE NOT SEPARATELY ALLOCATED AND COSTED
(I)	FEES PAID TO AN AFFILIATED COMPANY
(J)	INCLUDES BOTH RISK AND NON-RISK ARBITRAGE TRADING
(K)	ENTIRE DEPARTMENT INCLUDING OPTION AND OTHER TRADING
(L)	DOES NOT INCLUDE PARTNERS' COMPENSATION AND DISTRIBUTION
(M)	INCLUDES PERFORMANCE PAYMENTS
(N)	BEFORE COMPENSATION EXPENSES-PERSONNEL ALSO ASSIGNED TO OTHER TRADING AS WELL AS ARBITRAGE
(O)	NOT SOLELY FOR RISK ARBITRAGE
(P)	INCLUDES COMPENSATION TO THIRD PARTY ACCOUNT MANAGER

We believe that takeover legislation should be even-handed. We commend the bill's drafters for seeking to balance the burdens on bidders and on targets. We recognize that the Securities and Exchange Commission (the "SEC") has in the past promulgated a variety of rules that affect corporate governance in varying degrees.[1] Nevertheless, these limited and *ad hoc* situations differ from an expansion of the authority of the SEC under this bill.

We recognize that Section 12 of the bill seeks to preserve state control of corporate governance and we hope that this will be a guiding principle in the ultimate enactment of any legislation. We also recognize a need for balance and line-drawing. We would hope that Congress will make clear in reports on the bill that Section 12 is not intended to encourage states (particularly states which are not the incorporating state) to adopt conflicting patterns of takeover regulation, which could result in Balkanization and confusion of regulation of interstate commerce in securities of publicly traded companies.

In summary, a critical and far-reaching issue raised by the proposed legislation is the appropriate delinection of governance authority between federal and state law. It is difficult to find a clear line of demarcation. On the one hand, there is no question as to the right of the federal government to deal with the tender offer process. On the other, our current system depends upon the preservation of state control of the governance of corporations. Without seeking to advance any black letter rule in this area, we strongly urge that Congress (and, insofar as Congress permits, the SEC) intervene in this process only to the extent absolutely necessary in order to protect the capital markets and the related public interest.

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[1] *E.g.*, inclusion of certain shareholder proposals in proxy statements (Rule 14a-8); requiring a target company to take a public position with respect to a tender offer for its shares (Rule 14e-2); and obtaining shareholder approval of benefit plans if certain transactions pursuant to the plans are to be exempt from short-swing profit liability claims under Section 16(b) of the Exchange Act (Rule 16b-3).

2. Areas Covered by the Bill Which Have Traditionally Been Reserved for State Regulation. The bill directly affects certain areas traditionally the subject of state regulation: corporate repurchases of stock; severance agreements; and poison pills.

a. Corporate repurchases of stock. Section 8 of the bill would prohibit a corporation's repurchase of shares at a premium over market from a 3%-plus shareholder who has owned shares for less than six months, unless the repurchase has been approved by the shareholders or is made pursuant to an offer to all shareholders.

We hold no brief for greenmail. Again, however, we are constrained to urge caution. The circumstances under which shareholder approval is required for corporate action have traditionally been left to state law. We also note that some state courts in reviewing corporate repurchases of shares in the context of takeovers have been skeptical of greenmail.[2] However, other courts have applied state law to permit greenmail payments and no clear consensus at the state level has yet evolved.[3] In either case, it is difficult to ascertain any justification for federal intervention in this area. To the extent that Congress seeks to deal with specific corporate acts deemed to constitute an "abuse," state corporate laws will inevitably be diminished as the source of organic corporate authority and governance.

Furthermore, corporate repurchases serve as an important and accepted use of corporate funds for purposes other than the payment of greenmail and should be protected. We believe the distinction is best made by courts which can assess the facts and determine whether purchases are for a valid corporate purpose or must be viewed as intended to entrench management. If the latter purpose is shown, the purchases will be prohibited. If Congress decides to sweep aside the common law in this area, at the very least a definition of "greenmail" is required to distinguish between beneficial corporate repurchases outside the tender process and those which may be perceived as abusive.

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[2] *E.g.*, *Heckmann* v. *Ahmanson*, 168 Cal. App. 3d 119, 214 Cal. Rep. 177 (2d Dist. 1985); *Samuel M. Feinberg Testamentary Trust* v. *Carter*, 652 F. Supp. 1066 (S.D.N.Y. 1987) (denying motion to dismiss claim that Goodrich directors breached their fiduciary duty by authorizing a repurchase at a premium from Carl Icahn).

[3] *E.g.*, *Good* v. *Texaco, Inc.*, No. 7501 (Del. Ch. June 12, 1986), *aff'd sub nom*. *Polk* v. *Good*, 507 A.2d 531 (Del. 1986).

b. Severance agreements. Section 8 of the bill would also prohibit a target company during a third party tender offer from entering into or amending an agreement that would increase the compensation of any officer or director (except for routine increases in compensation, or routine compensation agreements).

This section presents obvious interpretive questions which may make it very difficult (at best) to apply. What is a "routine compensation agreement"? What if a new executive is hired just as a tender offer begins? There is also a question as to whether the section will not in fact result in more severance agreements, a result the drafters may not have intended. If a company cannot adopt a severance agreement during a tender offer, will not companies be inclined to rush to adopt such arrangements in advance, before a tender offer comes?

We are hopeful that Congress will also consider the broader policy question whether reasonable severance agreements may not be desirable. Typically, the total amount potentially payable under severance agreements is small in relation to a company's market capitalization. Thus, severance agreements are not ordinarily a deterrent to takeovers.

And they may make it possible for target companies to retain the services of top management during a takeover attempt when management skills are needed to maximize values for shareholders and to forestall headhunters who are often seeking to lure them from their existing tenuous positions.

The real question boils down to whether there are enough abuses in the area to warrant federal securities and corporate law prohibitions in addition to the regulation already in effect under the Internal Revenue Code and state case law scrutiny of employment and severance arrangements in derivative actions.[4]

c. *Prohibition on poison pills*. Section 8 of the bill would make it unlawful for a target company, during a tender offer, to "grant, declare, or establish" any rights to acquire any securities which entitle the holder thereof to purchase securities of the issuer or any other corporation at less than the market value of such security if such right is conditioned upon a change of control or contest for control of the issuer.

The section would have the perhaps unintended effect of encouraging the adoption of poision pills because such adoption could be effected lawfully up until the time that a tender offer is commenced. However, the bill raises a possible interpretive question as to whether an issuer would be restricted from implementing a rights plan which had been established prior to the commencement of a tender offer. We suggest the bill be clear that previously declared rights could be distributed and exercised after a tender offer is commenced.

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[4] *See*, *e.g.*, *Koenigs* v. *Joseph Schlitz Brewing Co.*, 126 Wis. 2d 349, 377 N.W.2d 593 (1985); *Weinberger* v. *Shumway*, No. 547586 (Sup. Ct., San Diego, Cal. Sep. 19, 1985); *Buckhorn, Inc.* v. *Ropak Corp.*, Case No. C-2-86-1489 (S.D. Ohio Feb. 11, 1987) (holding unreasonable certain amendments made in the employment contract after a bidder began a tender offer).

The question for Congress is whether the abuses associated with poison pills warrant federal intrusion into target company defensive tactics. In many cases, bidders have not been deterred by the presence or adoption of poison pills. In almost all cases, when a hostile bid has been commenced, the ultimate outcome has been determined not by gimmicks, but by economics, and the target company has gone to the highest bidder or has afforded its shareholders more value, through a recapitalization, than was offered by the hostile bidder. We suggest that serious thought should be given to whether the propriety of defensive tactics, such as poison pills, in a particular situation is best determined, not by statute or rules which apply across-the-board regardless of the circumstances, but by case-by-case adjudication by courts applying state law concepts of directors' duties of loyalty and care. A court can determine whether in the particular circumstances (taking into account, for example, the nature of the bid, the percentage of shares sought, the likelihood of harm to holders of shares not purchased in the initial bid, the adequacy of the bid, the target's prospects, the nature of the study of alternatives undertaken by the target's directors, and the degree of the directors' personal interests in the transaction) a particular defensive action is reasonable. Certainly courts have not been shy in recent years to strike down a wide range of defensive measures which they determined to be improper -- poison pills,[5] crown jewel lock-up options,[6] golden parachutes[7] and stock issuance to the target company's management or its allies,[8] to name just a few. Nor have courts, applying state law,[9] been reluctant to uphold a significant number of defensive measures, including poison pills, when it is concluded that the particular measures are reasonable in relation to the threat posed.

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[5] *E.g.*, *Dynamics Corp.* v. *America* v. *CTS Corp.*, 794 F.2d 250 (7th Cir. 1986); *Amalgamated Sugar Co.* v. *NL Industries*, 644 F. Supp. 1229 (S.D.N.Y. 1986); *Spinner Corp.* v. *Princeville Development Corp.*, Civ. No. 86-0701 (D. Hawaii Oct. 31, 1986); *Buckhorn Inc.* v. *Ropak Corp.*, No. C-2-86-1489 (S.D. Ohio Feb. 11, 1987).

[6] *E.g.*, *Revlon, Inc.* v. *MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986); *Hanson Trust PLC* v. *ML SCM Acquisition Inc.*, 781 F.2d 264 (2d Cir. 1986).

[7] See note 3.

[8] *E.g.*, *Frantz Mfg. Co.* v. *EAC Industries*, 501 A.2d 401 (Del. 1985); *Norlin Corp.* v. *Rooney, Pace Inc.*, 744 F.2d 255 (2d Cir. 1984).

[9] *E.g.*, *Gelco Corp.* v. *Coniston Partners*, 682 F. Supp. 829 (D. Minn), *aff'd*, 811 F.2d 414 (8th Cir. 1987); *Moran* v. *Household International, Inc.*, 500 A.2d 1346 (Del. 1985).

B. The Tender Offer Process.

1. Duration of Tender Offers. Section 7 of the bill would require a 35 business day minimum period for any tender offer. There are significant differences of opinion as to the need for, or desirability of, extending the offering period. Some view the current 20 business day minimum period as adequate to serve the underlying purposes of the Williams Act; however, others view a longer period as desirable to the extent required to promote more orderly responses to tender offers. If the current minimum period is extended, the period of extension should be carefully determined so as to achieve its primary objective of enabling a more orderly response by the target company without shifting the balance against the bidder.[10]

The current requirement of 20 business days was adopted by the Commission in 1979 to provide an adequate period for investors whose securities are being sought to receive, review and react to the tender offer. Current regulation also requires the offer to remain open for 10 business days in the event the bidder increases or decreases the offering price or the percentage of securities being sought. In a contested situation, the bidder's offer will typically be open for more than 20 business days because of the requirements of the marketplace and the need to deal with a variety of problems, including competitive bids, litigation and the fulfillment of the conditions of the offer. In a recent interpretive release, the Commission set forth its views on minimum periods in addition to those established by rule. For changes approaching the significance of price and terms, the offer must remain open for ten business days from the date the change is published, sent or given to shareholders. For other material changes, the offer must remain open for five business days from the date of publication. The basis for the release is to provide adequate time for investors to react to such changes in the tender offer. Thus, the current regulatory framework already contemplates longer minimum periods, but only where they are needed to assure that investors have adequate time.

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[10] We do not recommend any particular period of extension, but there are some who believe that this should not exceed an additional week. Furthermore, to the extent that the proposed offer period is designed to allow for a shareholder vote on the bid, it should be recognized as a practical matter that such a time period may not necessarily be adequate for this purpose, given the need to decide upon a course of action, draft proxy materials, clear such materials with the SEC and allow at least three weeks for proxies to be mailed and returned by stockholders.

We question whether any marginal benefits to investors of a 35 business day period will be outweighed by the adverse effects on the tender offer process caused by such a period. The longer an offer remains open, the greater the risks involved. The greater the risk of failure of the bid, the less likely it will be made in the first place. If a bidder is financing its offer in whole or in part from outside sources, such as a bank, a 35 business day minimum period will make such financing more difficult and expensive. This may result not only in fewer tender offers, but lower offering prices for the bids that are made to account for increased financing and other expenses. We also recognize that an extended offering period will give target boards of directors more time to consider a range of alternatives to the bid (which could enhance ultimate value to shareholders). However, it is unclear to us whether courts applying the business judgment rule in takeovers would reach different results on defensive tactics if the tender offer which led to the company's response were open for a longer period.

2. Purchases by Means of Tender Offers. Section 7 of the bill would also prohibit acquisitions which result in beneficial ownership of more than 15% of a class of covered securities unless made by means of a tender offer or pursuant to exceptions established by the SEC. The section would have the effect of channeling stock purchase programs into a tender offer mold. The concept underlying this section was first proposed in the SEC's 1980 legislative package[11] and

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[11] Senate Comm. on Banking, Housing and Urban Affairs, Securities and Exchange Commission Report on Tender Offer Laws, 96th Cong., 2d Sess. 11, 60-63 and 89-91 (Comm. Print 1980). The proposal would have required all acquisitions of beneficial ownership of more than 10% of a specified class of (footnote continued)

was also the subject of a recommendation of the SEC's Advisory Committee on Tender Offers in 1983.[12] The major issues posed by Section 13 and the prior proposals are threefold: (1) necessity; (2) the threshold percentage; and (3) appropriate exceptions. While we discuss all of these issues below, we wish to emphasize that, as indicated at the outset, we question the need to fashion all changes of corporate control as tender offers and our discussion of the mechanics should not be seen as endorsing the basic concept.

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securities to be made by a "statutory offer" which was the equivalent of a tender offer. Exceptions were made for (1) offers pursuant to a statutory merger or acquisition; (2) solicitation of proxies; (3) acquisitions of 2% per year; (4) acquisitions from the issuer; and (5) acquisitions from no more than 10 persons in any 12 months pursuant to privately negotiated transactions. The exceptions were intended to preserve "free transferability of large security holdings" and to allow "persons to dispose of those holdings in privately negotiated transactions." Id. at 61-62.

[12] Advisory Committee on Tender Offers, Report of Recommendations (1983). Recommendation 14 prohibited any acquisition of voting securities if immediately following the acquisitions the acquiring person would own more than 20% of the voting power of the outstanding voting securities of the issuer unless such purchase was made from the issuer or pursuant to a tender offer. Recommendation 14 also provided that the SEC should retain broad exemptive power.

In a letter from the Section to Representative Timothy L. Wirth dated March 12, 1984 responding to his request for comments on the recommendations of the Advisory Committee on Tender Offers we said "we do not think it serves any public purpose to, in essence, force all change of control transactions into the tender offer mode." Since some of the issues Representative Wirth and the House Subcommittee which he chaired in 1984 presage certain provisions of H.R. 2172 a copy of our letter of August 12, 1984 is enclosed for your convenience.

As recent cases have indicated, it is possible to acquire a controlling interest through open market transactions without constituting a tender offer.[13] These large open market purchase programs have the effect of denying shareholders the opportunity to participate, on a pro rata basis, in the premium prices associated with tender offers and the disclosure the Williams Act requires for tender offers. However, these cases are exceptional and do not represent the majority or even a significant minority of the acquisitions of corporate control which are typically conducted by means of a conventional tender offer. Thus, there may be no need for such a sweeping use of the tender process and there may be a less restrictive means of dealing with the problems raised by *Hanson Trust* and *Carter Hawley Hale*. Both of these cases raise different and more limited issues than the general use of open market or private purchases in substantial share acquisitions.

The application of the Williams Act to open-market purchase programs beyond a particular threshold necessarily invokes the SEC's All-Holders and Best Price rules. This would be tantamount to legislative adoption of an "equal opportunity" rule in transactions which would represent a significant change in existing law. We believe that there is a consensus in the legal, business and financial communities that controlling shareholders have a right to receive a premium for their shares and, in any event, that this is a matter for state corporate law.

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[13] *SEC* v. *Carter Hawley Hale Stores, Inc.*, 760 F.2d 945 (9th Cir. 1985) (target's open market purchases of more than 50% of its shares over seven days as a defense against a hostile conventional tender offer held not to constitute issuer tender offer) and *Hanson Trust* v. *SCM Corp.*, 774 F.2d 47 (2d Cir. 1985) (purchases of 25% of target within three hours of announcement of abandonment of bidder's tender offer held not to constitute a separate tender offer or continuation of prior tender offer).

There are differing views on whether mandating the use of tender offers is desirable. The problem of determining a threshold level for requiring the use of tender offers brings into focus questions as to the basic concept. It also presents difficult questions as to what would be an appropriate level, especially when taking into account the proposed broadened definition of beneficial ownership. In setting a threshold, consideration should be given as to whether it is so low as to interfere with legitimate market transactions or so high as to enable control to be established without compliance.

At the 15% threshold, the aggregation of a purchase with prior holdings could result in substantially deterring toehold acquisitions. Thus, the 15% threshold could result in fewer bids which would not be beneficial to investors and would tilt the balance against bidders. In addition, it could limit the ability of a dissident shareholder to acquire sufficient stock to mount a viable proxy contest.

The 15% threshold may require many exceptions to recognize transactions that are not contemplated within the policy or purpose of the bill. This was one of the principal criticisms of the SEC's 1980 legislative proposal. Given the current definition of beneficial ownership, which would be expanded by the bill, myriad situations which do not result in the abuses Section 7 is intended to address would have to be provided for by rulemaking or administrative order. Market-making by and discretionary accounts managed by broker-dealers, underwriting by investment bankers, and purchases by mutual funds, pension funds, bank trust departments and other institutions could fall within the purview of Section 7 with respect to a large number of covered securities. Even assuming that exemptions could be fashioned, there would be a significant cost of compliance with the exemptions. These costs would of necessity be passed on to the consumer, i.e., the investors. While we are uncertain as to the specific threshold which should be adopted if tender offers are mandated, we believe a 15% threshold is too low. There would undoubtedly be many more exceptions required to the extent that there is a low threshold such as 15%. Conversely, if there were a higher threshold, the exceptions would be more limited.

With respect to exceptions, we would suggest that the following activities be specifically exempted at a minimum: market-making, underwriting, statutory mergers and consolidations, acquisition by gift or inheritance, acquisition by group formation and de minimis acquisitions. While these activities would likely be the subject of rulemaking, the time lag between enactment of the bill and final promulgation of rules could cause unnecessary uncertainty in the marketplace. Furthermore, there is nothing to be gained in leaving to the discretion of the SEC obvious and important exceptions to any rationale which supports the mandatory use of tender offers.

We also suggest that provision be made for the acquisition of preexisting or other substantial blocks held for a significant time period (i.e., at least six months). As currently drafted, Section 7 would prevent a person holding a large block of securities from selling it to one purchaser. For example, if A, a family trust, held 16% of a covered security for twenty years, it could not sell that block to B, a single purchaser. B could not buy the block from A without making a tender offer. If B makes a partial tender, A's shares will be prorated. And, B may not desire nor have the financial ability to tender for all shares. Thus, A would, of necessity, have to break up the block, risking the possibility of not selling it all or receiving a lower price. To preserve free transferability of shares by large security holders, we would suggest an exemption for certain large scale private transactions.

C. Amendments to Section 13D

1. Reduction of Section 13D Filing Period. There seems to be an informal but widespread consensus that the ten day filing window should be eliminated to the extent that it enables a holder who exceeds filing thresholds to acquire additional shares of the target without adequate notice to the trading market. It is only logical that if there is a legislative finding that a 5% (or other) ownership threshold requires public disclosure, further acquisitions should be discontinued until that disclosure is made. Nevertheless, the legislative proposal to require a public announcement and filing one business day after the threshold acquisition is not workable as a practical matter. More importantly, it is unnecessary in order to close what is generally considered a "loophole" in the existing law.

As practicing lawyers, we strongly urge you to consider the retention of the ten day filing period so that reliable and complete information may be included in the initial 13D Statement. It is frequently necessary for counsel to obtain a significant amount of information before the 13D Statement can be prepared and also before certain legal judgments can be made. This is particularly true since the bill proposes to significantly increase the scope of disclosure required and raises difficult questions with respect to the formation of a group for filing purposes and the corporate structure, financing and intent of the filer. If reliable and complete information is not available, either the 13D Statement will not be filed in a timely manner, or it will be filed in a manner which may mislead the market. It is not a valid assumption that all persons who cross a 13D filing threshold necessarily are poised to make a filing within 24 hours.

We suggest that the potential misuse of the ten day window can be eliminated without assuming the risks which are inherent in the current proposal. Simply stated, when a person crosses the filing threshold, the 13D Statement should be filed within the ten day period. However, such a person could only purchase securities of the issuer after the filing of the 13D Statement and the lapse of two trading days. This will create a significant incentive to file in less than the statutory ten day period if the filer desires to acquire additional securities of the target. So long as the filer cannot buy in the market without adequate disclosure, the legislative change will have achieved its objective.

The question of whether a public announcement is appropriate is difficult to answer. Once there is a limited public announcement there will be speculation and inquiries which would remain unanswered until the actual 13D Statement is filed. Therefore, a public announcement may not be in the public interest and may be of limited use to the trading market. On balance, it is our view that such an announcement should not be required but should be permitted if the filer has adequate information. It is also a fact that many filers of 13D Statements are not regularly engaged in the dissemination of news information and this could be burdensome to such filers.

2. The 13D Filing Threshold. As initially enacted in 1968, the Williams Act required reporting of a position in a company's stock, under section 13(d) of the Securities Exchange Act, only if the position exceeded 10%. In 1970, after extensive debate, the Congress reduced the reporting threshold to 5%, evidently on the basis that acquisition of 5% of a company's stock could involve a substantial step toward acquiring control, and that even if 5% ordinarily was not enough to influence control, the investing public was entitled to an "early warning system" at the 5% level.

There is no evidence to suggest that a reduction to 3% is necessary. It is difficult to imagine that ownership of 3% can involve a substantial step toward the acquisition of control. The result of a reduction in the percentage to 3% (especially in light of an expanded group definition) would simply lead to needless paperwork, with no corresponding benefit to the investing public. In addition, disclosure at the 3% level may have the unintended effect of increasing takeover speculation and rumor especially when coupled with a possible requirement to choose between control or investment intent at the outset of filing.

3. Additional 13D Disclosure Requirements. The reporting requirements under section 3 of the bill include disclosure by the filer of a 13D Statement of all communications within the 90 days preceding the acquisition regarding the purchaser's intention to purchase the securities subject to the filing between the purchaser and (i) other 13D or 13G filers or (ii) other persons who acquired stock of the issuer as a result of such communication.

The object of such a reporting requirement is presumably to deal with "parking" and other problems arising out of concerted action. We believe, based on our experience, that almost all contacts among investors do not rise to the level of parking or other concerted action. We also believe that contacts involving parking or other concerted action are adequately covered by the existing statute and rules. Exploration and contacts among investors on a private basis should not only be preserved but encouraged. The mere fact of disclosure may constitute a significant deterrent to communication among investors. The test of whether the stock of the issuer was acquired as a result of the communication is extremely vague and subjective and can only give rise to litigation. We fail to see any meaningful public interest in any such reporting requirement.

We also fail to see the merit in the bill's proposal to increase the scope of disclosure of financing for 13D Statements to include descriptions of all financing agreements, fees paid and plans for repayment. In most cases, such disclosure would not be material to the investing public. Should the 13D filer seek to acquire the issuer in a tender offer or merger such disclosure is material and currently required.

Under Section 3 of the bill, 13D filers would also be required to specify whether their purpose in acquiring shares is (i) to influence or acquire control of the issuer or (ii) only for investment. If a person specifies investment intent, such person may not acquire shares of the issuer by tender offer until six months after the filing of an amendment disclosing that the purpose of such filer is to influence or acquire control. This six month prohibition constitutes overkill. We fail to see how the public and shareholders are served by requiring a six month moratorium because of a change of intent. In many cases 13D filers may not know at the time of an initial filing whether their intent is investment only. A filer may be uncertain or change his mind because of changing conditions or otherwise. The law should not preclude free choice. Many otherwise passive investors may elect to specify possible control intent in order to avoid the six month delay should circumstances change and the investor later desires to seek or influence control. This, in turn, could be misleading to the market. If such a choice is required, we would suggest an approach similar to that utilized by the SEC in effecting changes from filing a 13G Statement to filing a 13D Statement. Current provisions prohibit 13G filers from voting, acquiring or disposing of shares for a ten day period after they have a change of intent and file a 13D Statement.[14] We believe this is within the SEC's current rulemaking authority and, therefore, Congress need not deal with this item specifically.

The bill would also expand the "group" concept to include two or more persons acting in a "consciously parallel manner" for the purpose of acquiring or holding securities of an issuer or influencing management. We strongly oppose any such definition. It is an unclear standard. While directed at investors who disclaim group formation but act together, it would likely sweep into the net a large group of investors who may have common cause but no other relationship. It is likely that such an expansion of the group definition will create a serious potential for litigation especially given the private right of action provided in Section 6 of the bill. The courts are certain to struggle with what would be a difficult concept. Acting in a parallel manner with knowledge is a potentially unfair concept which is bound to entrap innocent investors.

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[14] Rule 13d-1(b)(3)(i).

We believe the existing definition of "person" and "group", as interpreted by the courts, is sufficient to pick up any arrangements (however informal) to act in concert to buy or to vote shares. As the District Court put it in the recent *Champion Parts Rebuilders* case, a court will not "play ostrich in the face of strong circumstantial evidence", such as parallel share purchasing in a correlated manner, demonstrating the existence of a section 13(d) group.[15]

4. *Registration of Arbitrageurs*. We question the need for registering and regulating "tender offer arbitrageurs." Arbitrageurs are already subject to existing laws and rules which regulate their activities including the general antifraud rules and Rule 14e-3 which limit their ability to buy or sell securities while in possession of material inside information, the Section 13(d) reporting

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[15] *Champion Parts Rebuilders, Inc. v. Corpricer*, No. 86C8906. (N.D. Ill. April 9, 1987). *See also e.g.*, *Spinner Corp. v. Princeville Development Corp.*, Fed. Sec. L. Rep. ¶93,658 (D. Hawaii 1986) (shareholders were acting as a group and should have filed Schedule 13D); *Citizen First Bancorp Inc. v. Harrold*, Fed. Sec. L. Rep. ¶99,412 (W.D. Ky. 1983) (dissidents were a group; it "would require an unbecoming degree of naivete to believe that their activities were mere coincidences, not the result of group agreement").

requirements and insider trading sanctions. We fail to see the need for special regulation of tender offer arbitrage.

Moreover, we would be wary of any step which would lead to a limitation or discontinuance of risk arbitrage. The SEC has recognized the vital role played by arbitrageurs in the maintenance of the efficiency and liquidity of the American capital market. According to the SEC:

> "Arbitrageurs in a tender offer typically make money on the differential between the market price at the time the tender offer is announced and the tender price, which normally includes a premium above market. Their purchases enable the public investor to elect to avoid the risk that the tender will not be consummated or that it will be prorated."[16]

There are serious definitional problems with the term "tender offer arbitrageur" as included in the proposed bill. According to the bill, the term refers to any person "who regularly buys and sells, for its own account, or for the account of others, in response to, or in anticipation of, a merger, tender offer, recapitalization, restructing or similar transaction." Many different kinds of investors do precisely this. While the bill would exempt certain types of investors such as natural persons, mutual funds and employee benefit plans, all other investors would either have to register, or avoid regularly buying and selling stocks of companies which might be the subject of a tender offer or recapitalization or "similar transaction", on pain of violating a registration requirement. Would the University of Michigan have to register as an arbitrageur? The Roman Catholic Church? The definitional problems are obvious and serious.

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[16] Exchange Act Release No. 34-9325.

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We appreciate the opportunity to comment on this legislation. We are available to meet with the Senate Subcommittee and its staff to review the comments and recommendations set forth herein.

Respectfully submitted,

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Chairman, Section of Corporation, Banking and Business Law

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News Release

TWO-TIER TENDER OFFERS:
A MYTHECTOMY

Address to

The United Shareholders Association
Annual Meeting

Willard Hotel
Washington, D.C.

June 15, 1987

AND

The National Association of Manufacturers'
Congress of American Industry,
Government Regulation and
Competition Session

J.W. Marriott Hotel
Washington, D.C.

May 27, 1987

Joseph A. Grundfest
Commissioner

The views expressed herein are those of Commissioner Grundfest and do not necessarily represent those of the Commission, other Commissioners, or Commission staff.

Summary

In an address delivered before two separate groups, one generally opposed to takeovers (the National Association of Manufacturers) and one that generally supports a free market in takeover activity and more active shareholder control over corporate affairs (the United Shareholders Association), Commissioner Grundfest made the following observations about two-tier tender offers and pending takeover legislation:

Data suggest that two-tier bids have become all but extinct as a hostile takeover device in the past two years. Two-tier bids have, however, gained increasing popularity as a defensive technique. They are also used as a management LBO technique and as a means of financing friendly takeovers supported by target management. Therefore, to the extent that two-tier bids represent a coercive tactic,* such coercion may now be practiced more by corporate managements than hostile raiders.

Recently introduced legislation criticizes two-tier techniques when used by bidders. This legislation claims to be evenhanded because it seeks to limit "egregious defenses as well as coercive takeover tactics." However, this legislation is silent about the potential for coercion when essentially identical techniques are used by management. To the extent that legislation relating to two-tier offers is motivated by concern over shareholder coercion but addresses only hostile bids, and does not address coercion arising from management defensive maneuvers, questions are raised about the completeness, logic, and purpose of such legislative proposals.

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*Commissioner Grundfest questions whether hostile two-tier bids are coercive and, in this address, describes various competitive market forces, corporate charter provisions, poison pill plans, and court decisions that eliminate or ameliorate the possibility of coercion or abuse arising from two-tier bids. However, for purposes of this address, Commissioner Grundfest assumes, without agreeing, that hostile two-tier bids are potentially coercive.

TWO-TIER TENDER OFFERS:
A MYTHECTOMY[1]

United Shareholders Association
Annual Meeting
June 15, 1987

and

The National Association of Manufacturers'
Congress of American Industry,
Government Regulation Session
May 27, 1987

It's a pleasure to be here this afternoon to address this annual meeting of the United Shareholders Association.

As most of you know, the primary mission of the Securities and Exchange Commission is full disclosure--it's our job to make sure that the capital markets are run efficiently, fairly, and honestly. In the spirit of full disclosure, I am obliged to inform you that the speech I'm about to deliver is slightly used because about three weeks ago I delivered essentially the same address before the National Association of Manufacturers' Congress of American Industry, Government Regulation and Competition Session.

The reason I'm peddling used goods this afternoon is not that I'm running out of things to say about takeovers. Far from it, because at the pace the market is evolving and legislation is being introduced, I wonder sometimes whether we'll ever run out of things to say. Instead, I'm delivering this speech for a second time because there is substantial value in presenting an idea before audiences with different perspectives. The NAM audience was generally opposed to takeover activity. This group is, I suspect, a bit more charitably inclined. By presenting the same ideas before two audiences with such diverse views, I hope to avoid any suggestions that I preach only to the choir, and hope also to benefit from a broad range of audience reactions.

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[1] I would like to thank my legal counsel, Bernard S. Black, for his substantial assistance in the preparation of this address.

Mythectomy

In my address this afternoon, I will attempt to perform a delicate surgical procedure that is rarely successful in Washington, D.C. The procedure is called a mythectomy. Its goal is to extract myth from a public policy debate so that decisions can be reached on the basis of reality instead of perceptions that are carefully orchestrated to support a particular result.

Those of you who have dealt with lawyers and lobbyists in this town can appreciate the difficulty of this procedure. Washington is home to a large and lucrative myth-making industry. Myth-makers are expert at nurturing perceptions that are carefully crafted to support a client's desired conclusions. Those who take issue with popular myths run a substantial risk of incurring the myth-makers' wrath. Nonetheless, there are points in public policy debates at which a myth becomes so divorced from reality that it becomes necessary to tackle it head on, if for no other purpose than to cause some Washington mythologists to think twice about what they're saying.

The subject of today's mythectomy is the two-tier tender offer, a takeover tactic that has been widely criticized as one of the raiders' most abusive devices. Two-tier tender offers have frequently been invoked as a rationale for extensive state and Federal antitakeover legislation.[2] They have also been cited as justification for aggressive antitakeover defenses.[3] In fact, the two-tier bid ranks among the most vilified of all hostile bidder techniques.

But is this reputation accurate in today's takeover market? To the surprise of many, recent data suggest that the two-tier bids may now be more of a management defensive technique than a hostile bidder tactic. Therefore, if two-tier bids are coercive or abusive, as some critics claim, then perhaps appropriate measures need to be directed at managements that use two-tier bids to defend against all-cash offers, or to mount management-sponsored leveraged buyouts, and not against hostile bidders who, in any event, appear to have largely abandoned two-tier bids as a takeover technique. In support of this proposition, recent data show that:

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[2] *See, e.g.*, *CTS Corp. v. Dynamics Corp. of America*, ____U.S. _____, 107 S.Ct. 1637, 1646 (1987) citing the possibility of a two-tier offer as a rationale supporting Indiana's adoption of an antitakeover statute; Cong. Rec. S7594, S7597 (June 4, 1987) (statement of Sen. Proxmire); Cong. Rec. S7667 (June 4, 1987) (statement of Sen. Sanford); National Association of Manufacturers, *Protect Shareholders: Reform the Williams Act*, May 1987, at 3.

[3] *See, e.g.*, *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), in which the court allowed an exclusionary self-tender as a defensive strategy in part because of the perceived threat posed by a two-tier tender offer. *See also* Note, *Protecting Shareholders Against Partial and Two-Tier Takeovers: The "Poison Pill" Preferred*, 97 Harv. L. Rev. 1964 (1984).

1. Hostile two-tier bids are now relatively rare and the incidence of such bids has been declining steadily since at least 1983;

2. When bidders resort to two-tier tender offers they are used most frequently in friendly transactions or in management sponsored leveraged buyout proposals--not in hostile bids;

3. In recent hostile takeover contests, two-tier bids have also frequently been used in management-sponsored stock repurchase programs as a defense against "one-tier" bids that offer all shareholders cash for all their shares; and

4. Corporations and shareholders can defend themselves against outsiders' two-tier tender offers by adopting fair price amendments to corporate charters. Moreover, "lollipop" plans can provide managements with an effective defense against two-tier bids, even if the corporation has no fair price provision in place.[4]

Federal and state legislation is therefore unnecessary to prevent the abuses, if any, associated with hostile two-tier bids. However, the coercion or unfairness allegedly associated with two-tier bids continues to be present in connection with certain defensive tactics and friendly transactions. Shareholders do not have equivalent protection against management-supported defensive two-tier repurchases, which may well be more coercive than any third party two-tier bid. Therefore, if one concludes that two-tier bids are coercive, and that stockholders need to be protected against such tactics--conclusions to which I do not rush--then it follows that stockholders need to be protected against the coercion inherent in certain defensive maneuvers, management-sponsored LBOs, and friendly transactions, at least as much as they need to be protected against hostile bidder strategies that now appear to be relatively rare.

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[4] *See* *infra* note 16, for a description of such plans.

In other words, legislators who believe they have identified an evil in two-tier takeover techniques should perhaps look more carefully at certain management-sponsored maneuvers. To the extent that legislation is promoted on the rationale of protecting stockholders from coercion and abuse, it strains logic to allow managements to coerce and abuse their own stockholders by using precisely the same tactics decried if used by hostile bidders.

Before continuing with this analysis, I should note, as a caveat, that my focus today is on two-tier offers. Partial tender offers, which have both similarities to and differences from two-tier offers as used by both bidders and defending managements, are a subject for another day.

The Two-Tier Offer

The two-tier tender offer can be described quite simply. In a typical two-tier bid, the bidder--either friendly or hostile--offers to acquire the stock of the target company in a two step transaction. First there is a higher valued "front-end" tender offer, typically for cash, that is followed by a lower valued "back-end" offer, typically composed of securities. If enough shareholders tender into the front-end, the bidder obtains control and swaps the lower valued securities available in the back end for the remaining shares.

For example, if a company's shares trade at $50, a two-tier bidder may come along and offer $70 in cash for 51 percent of the shares and announce that he will later swap a package of securities for the remaining 49 percent. For purposes of this example, let's assume that the market estimates that the back end paper is worth $60 a share. The market will then assign a "blended value" to the bid that is equal roughly to a weighted average of the values of the front and back ends of the offer. In this example, that blended value is about $65--the average of the $70 per share in cash offered up front for half the shares and the $60 in securities offered down the road for the remaining shares. The market price, after allowing for the time value of money and the risk that the deal will collapse, will approach but not reach $65, assuming that no higher bids are expected.

Opponents of two-tier bids see them as coercive because shareholders who would prefer that the target remain independent might nonetheless tender out of fear that a majority of their colleagues will tender in the first tier, leaving the takeover opponent "squeezed out" in the lower valued second step of the transaction.[5] Opponents also claim that because individuals "do not possess the same access to information or investment skills as institutional investors, they are less likely to respond quickly and efficiently to takeover bids and are more likely to be saddled with the lower two-tier price."[6]

There is substantial cause to question whether these arguments against two-tier bids can withstand careful scrutiny because, among other reasons, available evidence suggests that the market can adequately police hostile two-tier offers and ameliorate whatever coercive effect their critics claim they have.[7] However, rather than argue the merits of two-tier takeovers, or explain why they might on average do more good than harm, I'll assume for purposes of this speech that two-tier bids are coercive. Now, if that's truly the case, then who is coercing stockholders in today's marketplace and where is the abuse most prevalent?

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[5] *See*, *e.g.*, Lipton, *Corporate Governance in the Age of Finance Corporatism*, U. Pa. L. Rev. (Forthcoming, 1987) (typescript at 81) citing *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623, 630 (D. Md. 1982); *Radol v. Thomas*, 534 F. Supp. 1302, 1312 (S.D. Ohio 1982); Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 Harv. L. Rev. 297, 337 (1974); Finkelstein, *Antitakeover Protection Against Two-Tier and Partial Tender Offers: The Validity of Fair Price, Mandatory Bid, and Flip-Over Provisions Under Delaware Law*, 11 Sec. Reg. L.J. 291, 292-293 (1984); Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 Colum. L. Rev. 249, 308 (1983); Note, *Protecting Shareholders Against Partial and Two-Tiered Takeovers: The "Poison Pill" Preferred*, 97 Harv. L. Rev. 1964, 1966 (1984).

[6] Lipton, *supra* note 6 at 81, citing Note, *Second-Step Transaction in Two-Tiered Takeovers: The Case for State Regulation*, 19 Ga. L. Rev. 343, 352-54 (1985).

As I've already suggested, the answer may surprise you.

Two-Tier Bids Are Now Rare and Tend to be Friendly[8]

Data describing the incidence of two-tier bids are difficult to gather. Subjective assessments must sometimes be made in classifying bids as two-tier and in describing the circumstances under which such bids are made and revised.[9] Accordingly, I do not want to overemphasize the precision of the numbers I am about to cite. I invite you carefully to examine the tables presented with the text of this address and let me know if you believe that transactions have been overlooked or mischaracterized. Even if some transactions should be described differently, I doubt those reclassifications would materially change the underlying trend upon which I base my conclusions.

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[7] For example, a study by the Commission's Office of the Chief Economist ("OCE") found that the blended premium in hostile two-tier bids is not significantly different from the premium paid in all-cash offers, and that the back-end premium paid in two-tier offers also involves a substantial premium (averaging 45% for the bids studied) over the pre-offer price. Office of the Chief Economist, The Economics of Any-or-All, Partial, and Two-Tier Tender Offers (1985). Moreover, if a bidder uses a two-tier structure to try to force a target's shareholders to accept a noncompetitively low price, a competing bidder could come along with a superior all-cash offer or a superior two-tier bid. The OCE study examined four instances in which two-tier bids competed with higher-valued all-cash offers, and in every instance the all-cash bid with the higher blended premium prevailed over the two-tier bid, save for one friendly two-tier bid that was protected by the target's management through a lock-up option against a competing any-or-all bid. The OCE study found no example of a situation in which a lower-valued two-tier bid that was not protected by target management prevailed. *See id.* at 22-23.

[8] For a description of the source of the data and the transactions involved see Tables 1 and 2, attached.

Data filed with the SEC suggest that two-tier tender offers reached their peak of popularity in 1982 and 1983 when there were 35 two-tier bids that accounted for about 20% of tender offers. The incidence of two-tier tender offers has, however, declined precipitously since then. In 1985 and 1986, for example, other than management-sponsored leveraged buyouts, there were only eleven two-tier bids that accounted for about 3% of all tender offers. In addition, Commission data reveal no two-tier bids in the first five months of 1987.

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[9] While the classic two-tier bid is simple to describe, the boundaries of the concept are uncertain and difficulties sometimes arise in determining whether a bid is in fact a "two-tier" bid. In some cases, the bidder asserts that the back-end paper has a value equal to the front-end cash. The bidder may also obtain an investment banker's opinion to that effect. In the data presented below, such bids are treated as two-tier bids because the securities are received later than the front-end cash (and hence have a lower present value) and because the bidder has not volunteered to purchase the securities from prospective sellers for the price he claims they are worth. However, where the equally-valued back-end securities are the bidder's publicly-traded common stock and the transaction otherwise qualifies as a tax-free reorganization, tax benefits may make the second step more valuable to some target shareholders. In these bids, uncertainty about the value of the securities is also lower. The possibility of coercion or abuse, if any, may therefore be lower in such transactions, and such offers are not treated as two-tier bids.

The composition of the two-tier bids made during 1985 and 1986 is, moreover, quite revealing. Of these eleven bids, only three were hostile throughout the takeover battle. And all three of these bids occurred more than two years ago. Two of these bids failed when managements responded with their own two-tier defensive techniques that could be characterized as more coercive than the techniques used by the raiders. The only fully hostile two-tier bid that succeeded was in an extremely small transaction for a company valued at $7 million. And, as I've mentioned, that transaction occurred more than two years ago.

All other two-tier tender offers mounted by outsiders in the past two years were either initially supported by target management or eventually obtained management support after the bid was sweetened. Management supported these bids despite any alleged coercive effect inherent in their two-tier structure. In two of these cases, target management accepted a two-tier white knight offer to counter an all-cash hostile bid. There, management actually preferred the white knight's two-tier deal with the allegedly coercive structure over a competing all-cash non-coercive bid. Perhaps management's preference was reasonable because in both instances the two-tier bids had higher blended values than the competing all-cash bids. But, if that's the case, the same argument should be available to support hostile two-tier bids with superior blended values.

A variety of factors have led to the sharp decline in front-end loaded two-tier hostile takeover activity. These factors include: (1) the courts' willingness to allow managements greater latitude in opposing two-tier bids than in opposing all-cash offers that promise all stockholders an equal premium;[10] (2) the current availability of junk bonds and "bridge" financing as a source of financing to bidders who may not have in hand all the cash necessary to purchase 100% of a target's shares; and (3) the proliferation of fair price charter amendments and other defensive techniques that make corporations immune to two-tier bids.[11]

In sum, the data suggest that in today's market two-tier bids are relatively rare. When they do occur, they are often supported by target managements, and, as I am about to explain, one-tier bids have often been defeated by managements' own two-tier bid. Thus, the spectre of hostile two-tier bids run rampant through the marketplace appears to be a myth. Moreover, the image of embattled target managements that oppose two-tier bids because of their coercive effect on stockholders may also be a myth that is shattered in part by the frequency with which managements use two-tier bids when these tactics suit managements' purpose.

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[10] See, e.g., Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985) (poison pill adoption ruled a valid exercise of business judgment in part because of threat of two-tier offers).

[11] See infra pp. 14-16.

Defensive Two-Tier Bids

Although fully hostile two-tier bids verge on extinction, two-tier bids are alive and well when used by managements in support of management-sponsored leveraged buyouts or by managements defending against hostile tender offers that treat all stockholders equally.

The typical situation in which management uses a two-tier front-end loaded bid in response to an outsider's non-coercive bid that offers all stockholders the same consideration, involves a self-tender for some of the target company's shares at a price above the market price expected to prevail after the repurchase offer is completed. Shareholders who tender into management's repurchase offer get the higher priced front-end of the transaction. Those who don't are left with a "stub", i.e., the lower valued stock that remains after the first tier cash is paid out.

Because stockholders who oppose the repurchase might tender simply to avoid being frozen into the lower valued second tier, these repurchases have exactly the same coercive effect as any hostile two-tier bid. Moreover, if individuals are at an informational disadvantage relative to institutional holders, any informational inequities present in two-tier hostile bids are present also in management-sponsored defensive share repurchases. Thus, defensive share repurchase programs are essentially front-end loaded two-tier tender offers proposed by management to the company's stockholders.

This technique became popular in 1985, beginning with Phillips' defense against Boone Pickens. It was also used by Unocal in its self-tender for 30% of its shares at $72 per share, while the remaining shares dropped to $28 after the offer was completed.[12] Other examples of front-end loaded two-tier self-tenders are listed in Table 2 and include: (1) Anderson Clayton's attempted defense against AC Acquisitions, which was enjoined by the Delaware court because of its coercive effect on a hostile bid that was conceded to be at a fair price; (2) Union Carbide's defense against GAF; (3) Gelco's defense against Coniston Partners; and (4) Goodyear's combination greenmail/self-tender defense against Sir James Goldsmith.

In addition, target company managements have occasionally resorted to two-tier management leveraged buyout offers in response to unwelcome bids that offer cash to all shareholders. Examples of this coercive management response include buyout offers by the managements of SCM and Fruehauf.

Indeed, of the twelve examples of two-tier defensive self-tenders or management participation LBOs described in Table 2, the nine most recent transactions, all within the last two years, involved situations in which management proposed a two-tier transaction in response to a bid that was all-cash and offered on equal terms to all stockholders. The allegedly coercive effect of such management-sponsored techniques is especially apparent when the all-cash bid is at a price that the parties concede is fair, as in Anderson Clayton,[13] or when the target's own investment bankers concede that the outsiders' all-cash bid is more valuable than management's two-tier recapitalization proposal, as occurred in the battle for control of Gelco.[14]

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[12] Wall St. J., Apr. 24, 1985, at 5 col. 1.

It therefore appears that whatever abuse and coercion is associated with two-tier takeovers is now present primarily on the defensive side in hostile takeover battles. Critics of the takeover wars who allege unfairness because of bidder two-tier offers might therefore profitably examine current defensive tactics and ask themselves whether some of these tactics might not be more coercive than any hostile two-tier bid ever made.

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[13] AC Acquisition v. Anderson Clayton & Co., 519 A.2d 103 (Del. Ch. 1986); Wall St. J., Aug. 25, 1986, at 4 col. 2.

[14] Wall St. J., Oct. 8, 1986, at 6 col. 5. Defensive two-tier bids, unlike hostile bids, can also be combined with lock-up options (as in SCM's defense against Hanson Trust), debt with antitakeover covenants (as in CBS's defense against Ted Turner), or poison pills (as in Gelco's defense against Coniston Partners), to help ensure that the stockholders have a strong incentive to accept management's offer. Charter amendments could, in theory, provide some protection against such defensive tactics, but managements are unlikely to propose such provisions.

Non-Legislative and Non-Coercive Defenses Against Hostile Two-Tier Bids

Interestingly, a recent survey found that 158 of the Fortune 500, or 32% of the list, have adopted fair price charter amendments that essentially render the company immune to coercive hostile two-tier tender offers.[15] The widespread presence of these fair price provisions demonstrates that state or Federal antitakeover law is unnecessary as a deterrent to unwanted two-tier bids because any group of stockholders and management that wants to prevent a front-end loaded two-tier bid need only adopt an appropriate fair price provision.[16] Also, as Professor Romano of Yale Law School has recently pointed out, the net effect of state antitakeover laws that impose fair price provisions may be harmful because such laws cause corporations to become subject to fair price provisions that stockholders may not want.[17] Indeed even if stockholders do want fair price provisions, they may not want the specific provisions imposed by the statute and may well prefer provisions that individual companies can craft for themselves.[18]

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[15] V. Rosenbaum, Takeover Defenses: Profiles of the Fortune 500, Investor Responsibility Research Center (1987).

[16] Corporations that have not adopted fair-price provisions when a takeover bid is made still have substantial defenses against a two-tier bid. In many states, including Delaware, the directors, in the exercise of their business judgment and subject to solvency concerns, may issue rights to all shareholders giving them the power to sell any shares not purchased in the first-step tender offer back to the corporation at a reasonable price--so called "back-end poison pills" or "lollipops." See, e.g., Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 180-81 (Del. 1986). Courts are likely to uphold as reasonable a price equal to an outside bidder's front-end tender offer price, and this defensive tactic places a substantial impediment in the path of a front-end loaded two-tier bid, even if the corporation has no fair price provision in its charter.

Federal or state legislation restricting hostile two-tier transactions may therefore be unnecessary. In addition, if, as I would argue, the market can adequately police the potential for coercion and abuse resulting from hostile two-tier bids, the adoption of such legislation at the federal or state level would also be unwise.

Whither Legislation?

These data lead to interesting crossroads when it comes to considering the appropriate legislative response to the perceived coercion associated with two-tier takeovers. For example, Senator Proxmire, in a statement accompanying his recently introduced legislation, claims that two-tier tender offers "are inherently coercive in that they place enormous pressure on the stockholder to sell his shares to the raider in order to avoid a lower price in the second tier or in a subsequent freeze-out merger."[19] Senator Proxmire also stated that "tender offers themselves should be neither encouraged nor discouraged by law; egregious defenses as well as coercive takeover tactics should be limited."[20]

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[17] Romano, The Political Economy of Takeover Statutes, 73 Va. L. Rev. 111 (1987). Stockholders might not want a fair price provision because, among other reasons: (i) they may restrict bidders' use of certain forms of consideration (e.g., part cash, part securities) in takeovers, and this loss of flexibility may lead to fewer takeovers; (ii) they may prevent a controlling stockholder from receiving more than a pro rata share of the control premium, and other stockholders may be willing to accept less than a pro rata share to induce the controlling stockholder to agree to a takeover; and (iii) stockholders may prefer a lower-valued second step to the alternative of a partial tender offer without a second step.

[18] For example, Maryland's corporation law contains a so-called "fair-price" provision that can require a second-step merger to be at a higher price than the first step. See Md. Gen. Corp. Law § 3-603. Such a provision may prevent an acquiror from making an any-or-all tender offer, or from completing a second-step merger equal in value to the first-tier, even if a majority of the stockholders would prefer such an offer or merger.

Well, if a two-tier bid is "inherently coercive," a two-tier repurchase has precisely the same inherently coercive effect. The Proxmire legislation, however, does nothing to address the coercion inherent in these defensive techniques. Why is that? Is it an oversight? Is it because, for some reason I fail to understand, a management-supported two-tier self-tender is non-coercive, even if it is in response to an all-cash offer, whereas a hostile bid on exactly the same terms and conditions is invariably coercive? Or is it because the goal of some legislation is to shut down as much takeover activity as possible? If so, stockholder coercion may serve primarily as a convenient rationale for antitakeover legislation, provided that the rationale is not applied with equal vigor to defensive techniques.

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[19] Cong. Rec. S7594, S7597 (June 4, 1987) (statement of Sen. Proxmire).

[20] *Id.* at S7596.

Conclusion

Hostile takeovers raise many serious and legitimate concerns regarding corporate governance and the competitiveness of our economy. The spectre of widespread front-end loaded two-tier hostile takeovers is not, however, such a concern. As I've explained, hostile two-tier takeovers are quite rare and, even if they became common, the corporate chartering mechanism, combined with recent court decisions and the availability of "lollipop" plans, would be able to control the potential for coercion. Thus, federal or state legislation to address hostile two-tier offers is unnecessary.

Ironically, however, the front-end loaded two-tier technique has been embraced by managers who oppose takeovers. Recently introduced takeover legislation that is highly critical of two-tier techniques when used by bidders is, however, silent with regard to the same techniques when used by defending managements. The debate over coercive or abusive two-tier techniques has thus come full circle: some managements defending against hostile bids that treat all shareholders equally now find themselves using two-tier tactics that they vilify when used by raiders. Therefore, those who sincerely fear the coercion and abuse allegedly inherent in two-tier tender offers might want to scrutinize certain management defensive tactics more carefully than the tactics used by bidders mounting recent takeover attempts.

TABLE 1

Two-Tier Bids by Third Parties
Excluding Management-Participation LBO's

January 1985 - May 1987

Bidder	Target	Date Offer Commenced	Transaction Type (H = Hostile) (F = Friendly) (W = White Knight) Initial	Final	Offer Completed?
Successful					
Johnson Controls	Hoover Universal	3/4/85	F	F	Yes
Lexicon	Scope	5/15/85	H	H	Yes[1]
Allied Corp.	Signal Cos.	5/17/85	F	F	Yes
Minstar	AMF	6/18/85	H	F	Yes[2]
Occidental Petroleum	Midcon Co.	1/7/86	F, W	F	Yes[3]
Burroughs	Sperry Corp.	5/8/86	H	F	Yes[4]
May Dept. Stores	Associated Dry Goods	6/26/86	H	F	Yes, As One-Tier Transaction[5]
Reuters	Instinet	11/13/86	F	F	Yes
Data Switch	T-Bar	11/26/86	F, W	F	Yes[6]
Unsuccessful					
Icahn	Phillips Petroleum	2/13/85	H	H	No[7]
Mesa Partners II	Unocal	4/8/85	H	H	No[8]

Source: Data gathered by Directorate of Economic & Policy Analysis from Schedule 14D-1 filings, supplemented by Office of Commissioner Grundfest.

Footnotes to Table 1

1/Lexicon completed its offer after Scope unsuccessfully solicited white knight offers and LBO financing. The total market value of the target was approximately $7 million based on the per share price offered by the bidder. See Wall St. J., May 24, 1985, at 4 col. 3; Wall St. J., June 13, 1985, at 25 col. 5; Wall St. J., July 3, 1985, at 4 col. 1.

2/AMF agreed to a merger after Minstar increased its bid in response to a white knight offer. See Wall St. J., June 17, 1985, at 10 col. 20.

3/Occidental's white knight bid defeated an all-cash hostile bid by Wagner & Brown and Freeport-McMoran. See Offer to Purchase of OPCO Acquisition Corp. dated January 7, 1986.

4/Sperry agreed to a merger following an increase in Burrough's bid. See Wall St. J., May 28, 1986, at 2 col. 2.

5/The parties ultimately agreed on a friendly stock-for-stock merger, an option presented by the bidder to the target at the time of the hostile offer. See Wall St. J., July 17, 1986, at 2 col. 2.

6/Data Switch's white knight bid was in response to an all-cash hostile bid by John Beall and Co. See Wall St. J., Dec. 23, 1986, at 10 col. 3.

7/Icahn's bid was a response to Phillips' two-tier defense against Pickens, in which Phillips repurchased Pickens' shares, and Phillips and a Phillips employee stock ownership plan proposed to purchase a substantial percentage of the outstanding Phillips shares. Phillips improved its offer and Icahn withdrew his bid. See Wall St. J., Feb. 6, 1985, at 2 col. 2.

8/Unocal responded to Mesa Partners' bid with a self-tender that involved far more extreme two-tier pricing than the Mesa Partners' bid. Unocal offered $72 in cash for approximately 30% of its stock in its self-tender; Unocal's stock dropped to $28 after the offer. Pickens had offered $54 in cash up front and securities that he valued at $54 on the back end. See Wall St. J., April 24, 1985, at 5 col. 1.

TABLE 2

Examples of
Defensive Self-Tenders
and Management-Participation LBO's
that Operate as Two-Tier Offers

January 1985 - May 1987

Target	Hostile Bidder	Hostile Bid Type (O = One-Tier) (T = Two-Tier) (C = All Cash)	Date Offer Commenced	Defensive Transaction or LBO Completed?
Phillips Petroleum	Mesa Petroleum and Wagner & Brown	n.a.	12/24/84	Yes[1]
Unocal	Mesa Partners II	T	4/17/85	Yes[2]
CBS	Ted Turner	O	7/30/85	Yes[3]
SCM	Hanson Trust	O, C	9/16/85	No[4]
Union Carbide	GAF Corp.	O, C	12/16/85	Yes[5]
Fruehauf	Asher Edelman	O, C	6/27/86	No[6]
Anderson Clayton	AC Acquisitions	O, C	8/22/86	No[7]
Gelco	Coniston Partners	O, C	9/26/86	Yes[8]
Lucky Stores	Asher Edelman	O, C	10/13/86	Yes[9]
Goodyear	Sir James Goldsmith	O, C	11/6/86	Yes[10]
Gencorp	AFG Industries and Wagner & Brown	O, C	4/6/87	Pending[11]
Burlington Industries	Asher Edelman and Dominion Textiles	O, C	5/12/87	Pending Now As One-Tier Transaction[12]

Source: Data gathered by Office of the Chief Economist and staff of Commissioner Grundfest's office.

Footnotes to Table 2

1/Phillips Petroleum repurchased approximately 6% of its outstanding shares from Mesa Petroleum and Wagner & Brown (who had threatened a control contest but had not made a definite offer) at $53 per share and also repurchased an additional 50% of its outstanding shares from other shareholders for $62 face amount of debt securities per share. Mesa's hostile bid is not characterized because it is not clear from press reports whether it would have been two-tier, had a decision to start a tender offer been made. See Wall St. J., March 5, 1985, at 3 col. 1; Wall St. J., March 7, 1985, at 10 col. 1.

2/Unocal repurchased approximately 30% of its shares at $72 per share in response to a $54 per share bid by Mesa Partners II; after the offer was completed, the remaining shares traded in the market at approximately $28 per share. See Wall St. J., April 26, 1985, at 6 col. 1.

3/CBS repurchased approximately 20% of its outstanding shares for $150 per share; CBS stock traded in the market after the repurchase was announced at $115 per share. See Wall St. J., July 31, 1985, at 2 col. 2.

4/SCM management invested in a shell company formed by Merrill Lynch to complete a leveraged buyout in response to Hanson Trust's all-cash hostile bid. See Wall St. J., Sept. 12, 1985, at 3 col. 1. Hanson Trust eventually acquired SCM.

5/Union Carbide repurchased approximately 35% of its outstanding shares for $85 per share in response to a $74 per share all-cash bid by GAF Corp. See Wall St. J., Dec. 16, 1985, at 3 col. 1.

6/Fruehauf management invested in a shell company formed by Merrill Lynch to complete a defensive leveraged buyout in response to an Asher Edelman's all-cash hostile bid. After a counterbid by Edelman, Fruehauf agreed to a one-tier leveraged buyout. See Wall St. J., June 26, 1986, at 2 col. 2.

7/Anderson Clayton offered to repurchase approximately 66% of its outstanding shares for $60 per share in response to an all-cash bid of $56 per share by AC Acquisitions. The self-tender was enjoined by the Delaware Chancery Court. See AC Acquisitions v. Anderson Clayton & Co., 519 A.2d 103 (Del. Ch. 1986); Wall St. J., Aug. 25, 1986, at 4 col. 2.

8/Gelco repurchased approximately 23% of its outstanding shares at a price for $16 in cash plus securities that it valued at $16-$20 per share in response to a $26 per share all-cash bid by Coniston Partners. See Wall St. J., Oct. 8, 1986, at 6 col. 5.

9/Lucky Stores repurchased approximately 27% of its outstanding shares at $40 per share in response to $37 per share acquisition proposal by Asher Edelman. See Wall St. J., Dec. 23, 1986, at 8 col. 2.

10/Goodyear repurchased approximately 11% of its outstanding shares from Sir James Goldsmith at $50 per share and purchased an additional 37% of its outstanding shares through a self-tender at $50 per share. After announcement of the self-tender, Goodyear shares traded in the market at approximately $43 per share. See Wall St. J., Nov. 21, 1986 at 3 col. 1.

11/Gencorp expects to repurchase approximately 54% of its outstanding shares at $130 per share in response to an all-cash $100 per share offer by Wagner & Brown and AFG Industries. See Wall St. J., April 8, 1987, at 17 col. 2.

12/Burlington Textiles announced a repurchase of approximately 30% of its outstanding shares at $80 per share in response to an all-cash $67 per share bid by Asher Edelman. See Wall St. J., May 12, 1987, at col. 2. After Edelman increased his bid, Burlington proposed a one-tier leveraged buyout, which is pending.